

# Through the Looking Glass: Foreclosure by Sale as De Facto Strict Foreclosure-An Empirical Study of Mortgage Foreclosure and Subsequent Resale

Steven Wechsler

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### Recommended Citation

Steven Wechsler, *Through the Looking Glass: Foreclosure by Sale as De Facto Strict Foreclosure-An Empirical Study of Mortgage Foreclosure and Subsequent Resale*, 70 Cornell L. Rev. 850 (1985)  
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# THROUGH THE LOOKING GLASS: FORECLOSURE BY SALE AS *DE FACTO* STRICT FORECLOSURE—AN EMPIRICAL STUDY OF MORTGAGE FORECLOSURE AND SUBSEQUENT RESALE

*Steven Wechsler†*

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† Associate Professor of Law, Syracuse University College of Law; J.D., 1975; M.B.A., 1973, University of Michigan; Member, Colorado and New York Bars. I wish to acknowledge the generous support of the Syracuse University Senate Research Fund and the Syracuse University College of Law Center for Interdisciplinary Legal Studies, whose grants made this research possible. Special thanks are also due to Professor Edward J. Dudewicz, Chairman, University Statistics Council, Department of Mathematics, Syracuse University, who provided valuable expertise in statistical analysis; to my student assistants, Geoffrey Rogers, Chris Pratt, and Glenn Heller, who gathered the raw data from the public record; and to Walter Clark, who carried out the computer programming tasks.

## INTRODUCTION

*In September 1976, Thomas and Allison Wilson acquired their single-family home in Limeledge Estates, Marcellus, New York, for \$54,250. They put \$9,250 down and borrowed the balance of \$45,000 from Old Line Savings Bank at eight and one half percent interest, giving the Bank a conventional mortgage on the property. Two years later, in September 1978, the Wilsons defaulted on their loan and in early 1979 the Bank began a foreclosure action, obtaining a judgment of foreclosure in July 1979. The Bank posted notices of the foreclosure sale in three public places in Marcellus and published the notices for four successive weeks in the legal notices of the local newspaper. In August 1979 when the foreclosure sale was held, the Bank was owed \$52,000 (which included accrued interest, unpaid real estate taxes, the costs of the foreclosure action, and attorney's fees). The Bank bid \$51,800 for the property, leaving a deficiency amount of \$200.*

*The Bank made no attempt to collect the small deficiency from the Wilsons. In early April 1980 the Bank sold the home to an unrelated third party for \$60,000. Seven months after acquiring the property at the foreclosure sale, the Bank thus recovered its entire investment of \$52,000 and made a profit of about \$8,000. Under the current state of the law, the Bank was entitled to retain this profit.*

The foregoing report describes an actual mortgage foreclosure and the subsequent resale of the foreclosed property.<sup>1</sup> The result of this foreclosure by judicially supervised public sale, with all its statutory formalities and requirements,<sup>2</sup> was that the mortgagee rather than the mortgagor received the value of the property in excess of the debt balance. If the Wilson story were an isolated exception in the world of mortgage foreclosure, it would be of little interest to scholars and legislators; however, the study reported here demonstrates that profitable resale, as in the Wilson case, is relatively common. The current law of mortgage foreclosure apparently is not producing its intended results, and this Article recommends further examination and reform.

These recommendations are based on the results of an empirical study of all completed mortgage foreclosures in Onondaga County, New York, occurring during 1979.<sup>3</sup> The study had two purposes: to measure the frequency and profitability of resales of properties purchased at foreclosure sales by mortgagees and to pro-

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<sup>1</sup> Although the facts in this example are from public records, the names of the mortgagor and mortgagee have been changed in the interest of privacy. The "Wilson" case is file number 289 in Appendix A.

<sup>2</sup> These requirements include, for example, commencing an action to foreclose on the property, posting and publishing the notices, and holding a public sale. See *infra* notes 88-98 and accompanying text. The published notice of the foreclosure sale in the "Wilson" case is set out *infra* note 236.

<sup>3</sup> All data for the study was gathered by August 1, 1984.

vide a current picture of mortgage foreclosure based on the results of this sample, so that proposals for reform may be tailored to the realities of the marketplace.

The intended effects of our law of mortgage foreclosure are clear: when a borrower defaults on a mortgage obligation, the lender is entitled to foreclose on the property given as security. Foreclosure involves court action,<sup>4</sup> notice to the interested parties, and advertisement of a public sale. The public sale is intended to produce the best possible price to preserve any equity in the property for the mortgagor or junior lienors. If the sale does not produce an amount sufficient to liquidate the debt, the mortgagee is entitled to look to the mortgagor for a deficiency. This procedure was long ago substituted for strict foreclosure, under which the mortgagee merely took title to the property in exchange for the balance of the debt.<sup>5</sup>

Although the intended effects of foreclosure laws are clear, knowledge of the actual effects is less certain. Much of what we believe is based on unsupported anecdotal evidence,<sup>6</sup> extrapolations from reported cases,<sup>7</sup> and studies that are now about fifty years old.<sup>8</sup>

<sup>4</sup> Foreclosure by a power of sale does not require court action. See *infra* note 94 and accompanying text.

<sup>5</sup> See *infra* notes 41-43 and accompanying text.

<sup>6</sup> See, e.g., Abbott, *Some Basic Priority Problems in a Land Development Project in Mississippi With Emphasis Upon Power of Sale Foreclosure Procedures*, 50 MISS. L.J. 665, 680 (1979) ("It has been the experience of this author . . ."); Durfee & Doddridge, *Redemption From Foreclosure Sale—the Uniform Mortgage Act*, 23 MICH. L. REV. 825, 833 (1925) (citing HANDBOOK OF COMMISSIONERS ON UNIFORM STATE LAWS 275 (1922)); Nelson, *Deficiency Judgments After Real Estate Foreclosures in Missouri: Some Modest Proposals*, 47 MO. L. REV. 151, 152 (1982); Prather, *Foreclosure of the Security Interest*, 1957 U. ILL. L.F. 420, 438 (noting purported lack of value of deficiency judgment) (1957).

<sup>7</sup> See, e.g., Washburn, *The Judicial and Legislative Response to Price Inadequacy in Mortgage Foreclosure Sales*, 53 S. CAL. L. REV. 843, 848 nn.31-33 (1980) (citing cases).

<sup>8</sup> See Bridewell, *The Effects of Defective Mortgage Laws on Home Financing*, 5 LAW & CONTEMP. PROBS. 545, 558 (1938) (reporting 1938 study by the HOLC); Carey & Brabner-Smith, with Lansden & Sullivan, *Studies in Foreclosures in Cook County*, (pts. 1-4), 27 ILL. L. REV. 475, 595, 717, 849 (1933) (four-part article reporting results of 1932 empirical study "of mortgage foreclosure practices in Cook County," *id.* at 475) [hereinafter cited as Carey & Brabner-Smith]; REPORT OF THE JOINT LEGISLATIVE COMMITTEE ON MORTGAGE MORATORIUM AND DEFICIENCY JUDGMENTS (N.Y. LEG. DOC. NO. 58, 1938) (cited in Prather, *supra* note 6, at 452 n.90); Fairchild, *Foreclosure Methods and Costs: A Revaluation*, 7 BROOKLYN L. REV. 1, 5-7 (1937) (citing *Report of Investigation on Cost and Procedure in Mortgage Foreclosure*, Survey of Real Estate Laws [U.S.W.P.A. PROJECT NO. 352 (1936)]); Skilton, *Government and the Mortgage Debtor 1940-1946*, 95 U. PA. L. REV. 119, 129 (1946) (reporting study of sheriff's sales in Philadelphia County from 1941 to 1946).

The foreclosure of security interests in personal property has received more recent attention. See Shuchman, *Profit on Default: An Archival Study of Automobile Repossession and Resale*, 22 STAN. L. REV. 20 (1969); Comment, *Business as Usual: An Empirical Study of Automobile Deficiency Judgment Suits in the District of Columbia*, 3 CONN. L. REV. 511 (1971); Note, *I Can Get It For You Wholesale: The Lingering Problem of Automobile Deficiency Judgments*, 27 STAN. L. REV. 1081 (1975).

Descriptions of foreclosure by sale have varied through the years. Some asserted that surpluses are more common than deficiencies,<sup>9</sup> while others believed surpluses are rare.<sup>10</sup> While some observers noted that bidders are plentiful in times of prosperity,<sup>11</sup> others argued that mortgagees generally are the only ones to bid and purchase.<sup>12</sup> Some commentators posited that fair prices are not obtained at public sales,<sup>13</sup> that mortgagees buy at nominal prices<sup>14</sup> or for the amount of the debt,<sup>15</sup> that mortgagees collect deficiencies and sell for more than the bid price at a profit,<sup>16</sup> that mortgagees either do not bother pursuing deficiencies<sup>17</sup> or are unsuccessful in that pursuit,<sup>18</sup> and that mortgagees who purchase at foreclosure sales always suffer losses.<sup>19</sup>

The study discussed in this Article confirms some of these conventional beliefs and refutes others. The study shows, for example, that third parties buy at foreclosure sales more often than previous reports suggest and that such purchases are more likely to produce surpluses than are purchases by mortgagees. The study also shows that mortgagees rarely pursue deficiencies and that while on the average mortgagees lose money when they foreclose, many individual transactions result in profitable resales. This report thus provides a current look at the effects of foreclosure law and establishes a basis for reform proposals.

Scholarly literature has occasionally recognized that the results

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<sup>9</sup> E.g., Brabner-Smith, *Economic Aspects of the Deficiency Judgment*, 20 VA. L. REV. 719, 721 (1934).

<sup>10</sup> E.g., McGovern, *Forfeiture, Inequality of Bargaining Power, and the Availability of Credit: An Historical Perspective*, 74 NW. U.L. REV. 141, 152 (1979); Washburn, *supra* note 7, at 851.

<sup>11</sup> E.g., Brabner-Smith, *supra* note 9, at 724.

<sup>12</sup> E.g., Durfee & Doddridge, *supra* note 6, at 833; Madsen, *Equitable Considerations of Mortgage Foreclosure and Redemption in Utah: A Need for Remedial Legislation*, 1976 UTAH L. REV. 327, 335 (1976); Madway, *A Mortgage Foreclosure Primer*, 8 CLEARINGHOUSE REV. 146, 170 (1974); Prather, *A Realistic Approach to Foreclosure*, 14 BUS. LAW. 132, 135 (1958); Prather, *supra* note 6, at 452; Nelson, *supra* note 6, at 152.

<sup>13</sup> E.g., Madsen, *supra* note 12, at 331; Comment, *Mortgages—"Depression Jurisprudence"—Remaining Effects in Statutory Law*, 47 MICH. L. REV. 254, 257 (1948).

<sup>14</sup> E.g., Washburn, *supra* note 7, at 848.

<sup>15</sup> E.g., Nelson, *supra* note 6, at 152.

<sup>16</sup> E.g., Washburn, *supra* note 7, at 849.

<sup>17</sup> E.g., Nelson, *supra* note 6, at 152.

<sup>18</sup> E.g., Prather, *supra* note 6, at 438; Washburn, *supra* note 7, at 850 ("mortgagees often fail to collect deficiency judgments").

<sup>19</sup> Local bankers and bank attorneys repeatedly expressed this sentiment to the author. These bank officials and their counsel, who work with mortgage foreclosures and the management and resale of properties acquired in foreclosure, appear to sincerely believe that "lenders always lose in foreclosures." This may be because, when taken as a group, losses do outweigh gains, *see infra* notes 177-79 and accompanying text. Bankers usually reacted with surprise at evidence of profits from the resale of foreclosed property and characterized such profitable transactions as nonrecurring oddities.

of foreclosure by sale are similar to those of strict foreclosure.<sup>20</sup> Several reported cases involved mortgagees who acquired land through foreclosure and subsequently resold it at a profit.<sup>21</sup> With one recent exception,<sup>22</sup> however, a profitable resale by the mortgagee has been considered only as a factor that might prevent the collection of a deficiency,<sup>23</sup> rather than as a remediable injustice.

A full-scale history of the development of mortgage law is beyond the scope of this Article; however, some discussion of that development will illuminate the purposes underlying the current state of the law. Part I briefly reviews the history of the American law of mortgages from its English antecedents to the present day. Part II discusses the methodology used to gather and analyze information for the study of 118 foreclosure sales occurring in Onondaga County, New York, during 1979 and the subsequent history of the foreclosed properties. Part III presents the results of the empirical study, demonstrating the frequency and magnitude of profitable resales and providing other data concerning mortgage foreclosures. Finally, Part IV analyzes the results of the study and reviews avenues for the reform of foreclosure law.

This Article concludes that in many ways, the present law of mortgage foreclosure is not producing the results originally intended, and that, while further empirical studies should be undertaken to confirm the analysis presented here, reform of the law of foreclosure is overdue.

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<sup>20</sup> See G. OSBORNE, HANDBOOK ON THE LAW OF MORTGAGES § 335, at 703, n.48 (2d ed. 1970) [hereinafter cited as OSBORNE]; Fairchild, *supra* note 8, at 5; Washburn, *supra* note 7, at 848, 850.

<sup>21</sup> E.g., Thompson v. Maslia, 127 Ga. App. 758, 195 S.E.2d 238 (1972) (upholding trial judge's opinion that for purposes of determining deficiency, price at public sale represents market value; price three months later irrelevant); Gordon v. Harris, 290 Mass. 482, 195 N.E. 744 (1935) (evidence of mortgagee's profitable resale insufficient to block deficiency judgment against mortgagor); Schultz v. Mead, 8 N.Y.S. 663 (1890), *aff'd*, 128 N.Y. 680, 29 N.E. 149 (1891) (upholding judgment for mortgagee in deficiency action despite mortgagee's profitable resale).

<sup>22</sup> Central Fin. Servs., Inc. v. Spears, 425 So. 2d 403 (Miss. 1983) (mortgagee's resale at two and one-half times price it bid at public sale unconscionable; profit returned to mortgagor).

<sup>23</sup> See Washburn, *supra* note 7, at 889 (courts generally do not grant relief to mortgagor contesting a deficiency whose only evidence is that mortgagee has made profit on property's resale); De Funiak, *Right to Deficiency Judgment Where Mortgagee Purchasing at Foreclosure Sale Has Later Resold at a Profit*, 27 Ky. L.J. 410 (1939) (decisive factor in whether to prevent collection of deficiency is fraud or unfairness in foreclosure sale, not whether mortgagee resold property at profit).

## I

## A BRIEF HISTORY OF MORTGAGE FORECLOSURE LAW

Throughout its development, the law of mortgage foreclosure<sup>24</sup> has taken a zig-zag path between the rights of mortgagors and those of mortgagees as the problems and needs of first one group and then the other were perceived as more pressing.<sup>25</sup> While the system is intended to do justice by balancing the interests of mortgagor and mortgagee, in practice, it falls short of that goal.

## A. Historical Development in England

In fourteenth century England the dominant form of mortgage was the conveyance of the fee to the mortgagee<sup>26</sup> upon the condition subsequent that if the mortgagor paid in full on or before the due date, he regained his estate.<sup>27</sup> Mortgagors were required to pay

<sup>24</sup> For good histories of the development of foreclosure law, see 4 AMERICAN LAW OF PROPERTY: A TREATISE ON THE LAW OF PROPERTY IN THE UNITED STATES 427-519 (1952); OSBORNE, *supra* note 20, §§ 1-21; G. OSBORNE, G. NELSON & D. WHITMAN, REAL ESTATE FINANCE LAW §§ 1.2-1.5 (1979) [hereinafter cited as OSBORNE, NELSON & WHITMAN]; Durfee & Doddridge, *supra* note 6, at 825-33; Lloyd, *Mortgages—The Genesis of the Lien Theory*, 32 YALE L.J. 233 (1923); McGovern, *supra* note 10, at 145-52; Tefft, *The Myth of Strict Foreclosure*, 4 U. CHI. L. REV. 575 (1937).

<sup>25</sup> See 9 G. THOMPSON, COMMENTARIES ON THE MODERN LAW OF REAL PROPERTY 693 (1958); Madway, *supra* note 12, at 148 ("For six hundred years mortgagor and mortgagee have sat at opposite ends of a see-saw, with the chancellor balanced nimbly at the fulcrum, throwing his weight first one way, then the other."); Prather, *supra* note 12, at 132 ("And true to tradition, the courts, as well as the legislatures and legal draftsmen, have zigzagged between the opposite poles of lender and borrower favoritism, adding a safeguard here and a rectification there."); Vaughan, *Reform of Mortgage Foreclosure Procedure—Possibilities Suggested by Honeyman v. Jacobs*, 88 U. PA. L. REV. 957, 958 (1940) ("Whereas economic conditions and the concomitant policy considerations may at one time require that the interests of one party be advanced, and this necessarily to the detriment of the other, similar dictates at another period prompt the court to swing the balance in the opposite direction."); Comment, *Connecticut Mortgage Foreclosure: Deficiency Judgments and Problems of Subsequent Encumbrancers*, 2 CONN. L. REV. 413 (1969-70) (description of changes in law).

<sup>26</sup> See OSBORNE, *supra* note 20, § 5, at 8; OSBORNE, NELSON & WHITMAN, *supra* note 24, § 1.2, at 5. In the early stages of mortgage development, the mortgagee often had possession of the property as well as legal title. 3 R. POWELL & P. ROHAN, THE LAW OF PROPERTY ¶ 438, at 547 (1984) [hereinafter cited as POWELL & ROHAN]. See also Madway, *supra* note 12, at 148. The mortgagee took possession because of the "abhorrence of the church of the practice of charging interest . . . . The pious Christian lender was forced to take possession of the property so that he could reap the rents and issues as recompense for his money lent." 9 G. THOMPSON, *supra* note 25, at 3. By the end of the sixteenth century or the middle of the seventeenth century it had become common for the mortgagor to retain possession, while the mortgagee had complete legal title to the property. POWELL & ROHAN, *supra*, ¶ 438, at 547; McGovern, *supra* note 10, at 148.

<sup>27</sup> The conveyance to the mortgagee was absolute on its face, even though its only purpose was to secure the debt. This state of affairs was vigorously criticized by Maitland, who wrote, "that is the worst of our mortgage deed . . . it is one long *suppression veri* and *suggestio falsi* (suppression of the truth and suggestion of falsehood). It does

on the day set,<sup>28</sup> known as the law day;<sup>29</sup> no excuse for late payment was acceptable.<sup>30</sup> Upon any failure to perform by the mortgagor, "title was absolute in the [mortgagee] and the mortgagor had finally and irrevocably lost his land."<sup>31</sup> The harshness of this rule led mortgagors to seek relief from the courts of equity. At first equity courts granted relief only on a special showing of fraud, oppression, or the like.<sup>32</sup> Equity soon recognized the injustice of the forfeiture inherent in this situation. By the end of the seventeenth century, equity routinely intervened to relieve the harshness of the common law mortgage;<sup>33</sup> all mortgagors could redeem their land, as a matter of right, by tendering the amount due within a reasonable period after the law day.<sup>34</sup> Thus, courts created the equity of redemption,<sup>35</sup> an equitable right of all mortgagors.<sup>36</sup>

While the equity of redemption relieved embattled mortgagors, it created new hardship for mortgagees, who no longer knew when their titles would be secure.<sup>37</sup> To free mortgagees from the open-ended threat that the mortgagor might redeem the property, equity allowed mortgagees to petition for foreclosure. Foreclosure terminated the mortgagor's equity of redemption;<sup>38</sup> the mortgagee al-

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not in the least explain the rights of the parties; it suggests that they are other than really they are." (footnote omitted) F. MAITLAND, *EQUITY* 269 (1909).

<sup>28</sup> OSBORNE, *supra* note 20, § 5, at 12; OSBORNE, NELSON & WHITMAN, *supra* note 24, § 1.2, at 7; POWELL & ROHAN, *supra* note 26, ¶ 438, at 547.

<sup>29</sup> OSBORNE, NELSON & WHITMAN, *supra* note 24, § 1.2, at 7.

<sup>30</sup> See *id.*; Madway, *supra* note 12, at 148. Indeed, the mortgagor might lose his land because the "lender [hid] in the woods all day in order to avoid receiving payment." J. COOPER-HILL & M. GREENBERG, *CASES AND MATERIALS ON MORTGAGES AND REAL ESTATE FINANCE* 3 (1982) [hereinafter cited as COOPER-HILL & GREENBERG].

<sup>31</sup> OSBORNE, *supra* note 20, § 5, at 9; see also Vaughan, *supra* note 25, at 959 (noting that under early law, "when the mortgagor failed to pay his debt on the due date, the mortgagee's title . . . became absolute . . .").

<sup>32</sup> OSBORNE, *supra* note 20, § 6, at 13.

<sup>33</sup> See OSBORNE, NELSON & WHITMAN, *supra* note 24, § 1.3, at 7; Madway, *supra* note 12, at 148. Osborne characterizes the intervention of equity as a sudden development early in the seventeenth century. OSBORNE, *supra* note 20, § 6, at 13.

<sup>34</sup> OSBORNE, NELSON & WHITMAN, *supra* note 24, § 1.3, at 7.

<sup>35</sup> "And so, a new right was born: the right of the mortgagor to pay his debt even after default, and in this manner to recover his property. This right came to be known as the 'equitable right to redemption,' or the 'equity of redemption.'" Madway, *supra* note 12, at 148.

<sup>36</sup> See A. AXELROD, C. BERGER & Q. JOHNSTONE, *LAND TRANSFER AND FINANCE: CASES AND MATERIALS* 157 (2d ed. 1978) [hereinafter cited as AXELROD, BERGER & JOHNSTONE]; Madway, *supra* note 12, at 148. The mortgagor could not bargain away this right either in the mortgage or in a contemporaneous agreement; this was known as the "prohibition against clogging the mortgagor's equity of redemption." OSBORNE, NELSON & WHITMAN, *supra* note 24, § 1.4, at 9.

<sup>37</sup> See AXELROD, BERGER & JOHNSTONE, *supra* note 36, at 157; OSBORNE, *supra* note 20, § 10, at 20; OSBORNE, NELSON & WHITMAN, *supra* note 24, § 1.3, at 7; Madway, *supra* note 12, at 148.

<sup>38</sup> OSBORNE, *supra* note 20, § 8, at 17 n.44. See also OSBORNE, NELSON & WHITMAN, *supra* note 24, § 1.3, at 8.



ready had legal title to the land, subject only to the right to redeem; therefore, extinguishing that right left the mortgagee as the absolute owner of the land.<sup>39</sup> Rather than creating any new rights, "the decree [of foreclosure] only professe[d] to close a door which equity had before kept open . . ."<sup>40</sup>

After foreclosure, the mortgagee was not obligated to account to the mortgagor for any surplus value in the property;<sup>41</sup> at the same time, procedural obstacles effectively prevented the mortgagee from collecting any deficiency.<sup>42</sup> The foreclosure action left the mortgagee with clear title to the property and resulted, in effect, in the mortgagee exchanging the debt for the land. This procedure is now called strict foreclosure.<sup>43</sup> It was not known as strict foreclosure in England,<sup>44</sup> nor was it in any sense "strict."<sup>45</sup> Indeed, in England, foreclosure without sale included so many safeguards to protect the rights of mortgagors<sup>46</sup> that mortgagees first sought "sales in lieu of foreclosure" to protect their position.<sup>47</sup> Foreclosure by sale developed slowly in England and was not generally available until the

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<sup>39</sup> See Brabner-Smith, *supra* note 9, at 720-21 & n.2 (title to property absolute in mortgagee and mortgagor is entirely divested of his interest in premises if proceeding finds mortgage debt unpaid); McGovern, *supra* note 10, at 145 (strict foreclosure as currently recognized).

<sup>40</sup> 1 C. WILTSIE, REAL PROPERTY MORTGAGE FORECLOSURE § 2, at 10 (5th ed. 1939); Goodman v. White, 26 Conn. 316, 321 (1857).

<sup>41</sup> Brabner-Smith, *supra* note 9, at 720 n.2.

<sup>42</sup> The deficiency judgment as such was unknown in the early stages of English mortgage law. See *id.* at 719; Vaughan, *supra* note 25, at 961. The mortgagee could sue on the debt if the value of the foreclosed property was insufficient to satisfy it. *Id.*; OSBORNE, *supra* note 20, § 311, at 649. If the mortgagee opted to sue on the debt, this action reopened the foreclosure and reinstated the equity of redemption. If the mortgagee sold the property after foreclosure, he could not sue on the debt. *Id.* at 649-50; Tefft, *supra* note 24, at 586. As a result, mortgagees who foreclosed had no effective means of collecting deficiencies, even if the value of the land was insufficient to satisfy the debt.

<sup>43</sup> Brabner-Smith, *supra* note 9, at 720 & n.2; Madway, *supra* note 12, at 148. It is interesting that strict foreclosure developed as a historical accident, growing out of the fourteenth century form of mortgage as a conveyance of title to the mortgagee. Strict foreclosure, in turn, led to the development of the equity of redemption, and eventually to the development of the foreclosure of the equity of redemption. See Comment, *supra* note 25, at 413-14; *supra* text accompanying notes 26-40.

<sup>44</sup> See OSBORNE, *supra* note 20, § 312, at 652-53 (noting the differences in terminology regarding foreclosures in the United States and England); Tefft, *supra* note 24, at 577 (accord).

<sup>45</sup> Tefft, *supra* note 24, at 577.

<sup>46</sup> The early foreclosure proceeding was slow and costly. Typically, many months passed before entry of a decree, followed by an accounting. After the accounting, the mortgagor routinely received an additional six months in which to redeem. Courts sometimes permitted further extensions, and sometimes reopened the final decree. Since even a purchaser from the mortgagee might be subject to the reopening of the final decree, the mortgagee's title obtained through foreclosure was not marketable. See OSBORNE, *supra* note 20, § 311, at 648-49; Tefft, *supra* note 24, at 577-79.

<sup>47</sup> See McGovern, *supra* note 10, at 151; Tefft, *supra* note 24, at 579-80.

middle of the nineteenth century.<sup>48</sup>

## B. Historical Development in the United States

Although the American colonies initially embraced English mortgage law,<sup>49</sup> the law governing mortgages in this country soon developed its own characteristics. In this country, foreclosure without sale quickly earned the epithet of "strict foreclosure" because it proved to be unduly harsh on mortgagors.<sup>50</sup> Foreclosure by sale received a warm reception<sup>51</sup> for several reasons. First, the remedy of strict foreclosure was much more summary here than in England because American courts operated with greater efficiency than their English counterparts.<sup>52</sup> American judges showed little regard for the rights of mortgagors and rarely granted the extensions and delays that had protected English mortgagors.<sup>53</sup> Second, rapid and extreme fluctuations in land values made strict foreclosure particularly harsh.<sup>54</sup> Finally, because strict foreclosure cuts off the equity of redemption and leaves the mortgagee's title to the property unfettered, it is inconsistent with a theory in which the mortgagee's interest is limited to a lien on the property.<sup>55</sup> The widespread acceptance of the lien theory of mortgages<sup>56</sup> consequently contributed to the rise of foreclosure by sale and the decline of strict foreclosure.<sup>57</sup> By the early 1800s, foreclosure by sale was firmly established as the primary method of foreclosure in this country.<sup>58</sup>

<sup>48</sup> See Durfee & Doddridge, *supra* note 6, at 827; McGovern, *supra* note 10, at 150-51; Tefft, *supra* note 24, at 580.

<sup>49</sup> OSBORNE, *supra* note 20, § 13, at 23; Lloyd, *supra* note 24, at 240; Tefft, *supra* note 24, at 588.

<sup>50</sup> OSBORNE, *supra* note 20, § 312, at 652-53; Tefft, *supra* note 24, at 577.

<sup>51</sup> Durfee & Doddridge, *supra* note 6, at 828.

<sup>52</sup> OSBORNE, *supra* note 20, § 312, at 652; Tefft, *supra* note 24, at 588.

<sup>53</sup> OSBORNE, *supra* note 20, § 312, at 652; Tefft, *supra* note 24, at 588.

<sup>54</sup> OSBORNE, *supra* note 20, § 312, at 652; Tefft, *supra* note 24, at 588.

<sup>55</sup> OSBORNE, *supra* note 20, § 312, at 653.

<sup>56</sup> Three theories of mortgage law are extant in the United States: the title theory, under which the mortgagee retains title until the mortgage is satisfied or foreclosed; the lien theory, under which the mortgagee holds a security interest and no title; and the intermediate theory, under which the mortgagor has the right to possession until default and the mortgagee has that right after default. See OSBORNE, NELSON & WHITMAN, *supra* note 24, § 1.5, at 10; Madway, *supra* note 12, at 149; Prather, *supra* note 6, at 450-51. Even in states that embrace the title theory, it is acknowledged that the mortgagee has only a security interest. OSBORNE, NELSON & WHITMAN, *supra* note 24, § 1.5, at 10; POWELL & ROHAN, *supra* note 26, ¶ 439, at 549-52; Madsen, *supra* note 12, at 327. The choice of theory has few practical consequences. OSBORNE, NELSON & WHITMAN, *supra* note 24, § 1.5, at 10; Vaughan, *supra* note 25, at 980.

<sup>57</sup> Another reason foreclosure by sale developed more rapidly in the United States than in England may be the relative lack of sentimental inclination to keep land in the mortgagor's family from one generation to the next. McGovern, *supra* note 10, at 151.

<sup>58</sup> AXELROD, BERGER & JOHNSTONE, *supra* note 36, at 157-58; OSBORNE, *supra* note 20, § 318, at 661; Brabner-Smith, *supra* note 9, at 721; Lifton, *Real Estate in Trouble*:

The substitution of foreclosure by sale for strict foreclosure was based on compelling policy considerations. Under strict foreclosure the mortgagee might acquire land far more valuable than the mortgage debt, a result considered harsh, oppressive, and unfair.<sup>59</sup> Foreclosure by sale was viewed as a logical way<sup>60</sup> of protecting the debtor's equity in the property<sup>61</sup> while still allowing the mortgagee to recover a deficiency judgment when the proceeds of the sale fell short of the amount owed by the mortgagor.<sup>62</sup> Furthermore, during the early development of foreclosure by sale in the United States, the high level of activity in the real estate market<sup>63</sup> justified the conclusion that competitive bidding would assure fair prices.<sup>64</sup> In theory, public sales in such a market would reduce deficiencies and

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*Lender's Remedies Need an Overhaul*, 31 BUS. LAW. 1927, 1936 (1976). In contrast to the English practice, in this country the mortgagee is allowed to bid at the foreclosure sale. OSBORNE, *supra* note 20, § 318, at 662; Friedman, *The Enforcement of Personal Liability on Mortgage Debts in New York*, 51 YALE L.J. 382, 410-11 (1942); Madway, *supra* note 12, at 170; Tefft, *supra* note 24, at 589; Washburn, *supra* note 7, at 887. If the mortgagee is the successful bidder, he receives the same title to the property as a third-party purchaser. Durfee & Doddridge, *supra* note 6, at 843; Washburn, *supra* note 7, at 887. Another significant American development is the availability of the deficiency judgment. OSBORNE, *supra* note 20, § 318, at 662; POWELL & ROHAN, *supra* note 26, ¶ 462, at 696.50; Friedman, *supra*, at 383 & n.8; Vaughan, *supra* note 25, at 961, 963 n.33. Traditionally, the amount of the deficiency was conclusively determined by deducting the foreclosure sale price from the debt balance. OSBORNE, *supra* note 20, § 318, at 662-63; Tefft, *supra* note 24, at 594. The deficiency judgment generally was available in the same action as the foreclosure. OSBORNE, *supra* note 20, § 333, at 699, § 334, at 700. The English impediments to obtaining a deficiency, *see supra* note 42 and accompanying text, were not adopted in this country. Tefft, *supra* note 24, at 594. If the sale of the property produced more than the debt balance, the mortgagee had to account to the mortgagor for this surplus. OSBORNE, *supra* note 20, § 10, at 21; Vaughan, *supra* note 25, at 963 n.33.

<sup>59</sup> See OSBORNE, *supra* note 20, § 10, at 20; 2 C. WILTSIE, *supra* note 40, at § 919; Bridewell, *supra* note 8, at 529; Durfee & Doddridge, *supra* note 6, at 828; Lifton, *supra* note 58, at 1936; Tefft, *supra* note 24, at 595; Vaughan, *supra* note 25, at 960; Washburn, *supra* note 7, at 846, 851.

<sup>60</sup> "With the establishment of the doctrine . . . that a mortgage is a mere security for the payment of a debt, a breach of the condition for payment merely giving to the mortgagee a right to proceed against the security, the *natural remedy* for such breach was to sell the property and apply the proceeds thereof to the payment of the mortgage debt." 2 C. WILTSIE, *supra* note 40, § 918, at 1466 (emphasis added). See *United States v. Stadium Apartments, Inc.*, 425 F.2d 358, 368 (9th Cir. 1970) (Ely, J., dissenting); *see also* Fairchild, *supra* note 8, at 4-5.

<sup>61</sup> The mortgagor usually has some equity in the property at the outset because lenders typically advance only a portion of the purchase price. Additional equity is generated by increases in the market value of the property and by debt service payments, although the latter source does not add any significant equity during the early years of the loan when the payments are mostly interest. See Washburn, *supra* note 7, at 850 n.41.

<sup>62</sup> See *supra* note 58 for a discussion of the deficiency judgment.

<sup>63</sup> Brabner-Smith, *supra* note 9, at 721.

<sup>64</sup> Vaughan, *supra* note 25, at 963 n.33; Washburn, *supra* note 7, at 846; Comment, *supra* note 13, at 257; Note, *Redemption From Judicial Sales: A Study of the Illinois Statute*, 5 U. CHI. L. REV. 625, 626 (1938); Comment, *Statutory Redemption: The Enemy of Home Financing*, 28 WASH. L. REV. 39, 40 (1953).

perhaps yield surpluses, which could be paid to mortgageors or junior lienors.<sup>65</sup>

The theoretical attractiveness of foreclosure by sale soon became tarnished by public sales that did not produce spirited bidding and high prices.<sup>66</sup> During the economic depression of the 1820s, it became apparent that the public was only willing to pay bargain prices at foreclosure sales.<sup>67</sup> Absent serious competitive bidding, mortgagees usually were the successful bidders at foreclosure sales, and they paid low prices.<sup>68</sup> In response to this problem state legislatures began enacting statutory redemption laws.<sup>69</sup> These laws gave the mortgagor the right to redeem the property for a specified period of time after the foreclosure sale by paying the purchaser the amount of his winning bid.<sup>70</sup> Although one purpose of statutory redemption was to allow the foreclosed mortgagor another chance to regain his property,<sup>71</sup> the primary intent of these statutes was to boost foreclosure sale prices.<sup>72</sup> Theoretically, the mortgagee would pay a higher price at the foreclosure sale because a low bid would encourage the mortgagor to redeem the property, thus undoing the foreclosure.<sup>73</sup> These statutes remain in force in about half the states<sup>74</sup> despite the fact that statutory rights of redemption are

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<sup>65</sup> See Durfee & Doddridge, *supra* note 6, at 829; Nelson, *supra* note 6, at 163, 165; Comment, *supra* note 64, at 40. See also Washburn, *supra* note 7, at 936-38 (discussing underlying assumption in Uniform Land Transactions Act that both debtors' and creditors' interests are best served by sale at highest possible price). In the early days of foreclosure by sale in the United States, surpluses were more common than deficiencies due to the rapid increase in property values. Brabner-Smith, *supra* note 9, at 721.

<sup>66</sup> See Friedman, *supra* note 58, at 385-86; Comment, *supra* note 13, at 257; Note, *supra* note 64, at 626.

<sup>67</sup> See Durfee & Doddridge, *supra* note 6, at 832; Skilton, *supra* note 8, at 129.

<sup>68</sup> Madsen, *supra* note 12, at 329; Tefft, *supra* note 24, at 590; Note, *supra* note 64, at 626; see also Lifton, *supra* note 58, at 1937.

<sup>69</sup> OSBORNE, *supra* note 20, § 307, at 637-39; Durfee & Doddridge, *supra* note 6, at 834; Tefft, *supra* note 24, at 590.

<sup>70</sup> There is considerable variety in the mechanics of statutory redemption among the states that adopted it. See OSBORNE, NELSON & WHITMAN, *supra* note 24, § 8.4, at 537; Madway, *supra* note 12, at 149.

<sup>71</sup> OSBORNE, *supra* note 20, § 8, at 17-18; Durfee & Doddridge, *supra* note 6, at 839; Brabner-Smith, *supra* note 9, at 722. A secondary goal may have been to allow hard-pressed mortgagors to retain possession longer. OSBORNE, *supra* note 20, § 8, at 18.

<sup>72</sup> OSBORNE, *supra* note 20, § 8, at 18; OSBORNE, NELSON & WHITMAN, *supra* note 24, § 7.16, at 469; Durfee & Doddridge, *supra* note 6, at 840; Note, *supra* note 64, at 627.

<sup>73</sup> "The key to understanding the statutory redemption right lies in the proposition that the statute's operation is in the nature of a threat. When redemption is exercised, it is thereby evidenced that the mortgagee has not bid adequately at the sale. . . ." United States v. Stadium Apartments, Inc., 425 F.2d 358, 368 (9th Cir. 1970) (Ely, J., dissenting). See also Durfee & Doddridge, *supra* note 6, at 840-41; Washburn, *supra* note 7, at 931.

<sup>74</sup> OSBORNE, NELSON & WHITMAN, *supra* note 24, § 8.4, at 537; Madway, *supra* note 12, at 149; Prather, *supra* note 6, at 432. New York State does not provide for statutory redemption; therefore, it was not part of this study.

rarely exercised<sup>75</sup> and despite criticism that their effect is the opposite of that intended.<sup>76</sup>

While economic conditions during the 1820s focused attention on the low prices paid at foreclosure sales, the Great Depression of 1929 created a different problem. Mortgagees were again making foreclosure purchases at low prices and were then frequently using those low prices as the basis to vigorously pursue deficiency judgments against mortgagors.<sup>77</sup> This practice was perceived as an injustice<sup>78</sup> that some asserted contributed to the continuing economic depression.<sup>79</sup> The courts provided some small measure of relief by occasionally setting aside foreclosure sales on the basis of the inadequate prices bid.<sup>80</sup> State legislatures authorized more effective relief for mortgagors during this period. They enacted a wide variety of antideficiency laws<sup>81</sup> to protect mortgagors from losing their property to mortgagees by foreclosure at depressed prices and then facing deficiency judgments measured by those prices.<sup>82</sup> While a few states have prohibited deficiency judgments entirely,<sup>83</sup> a more common approach is to prohibit them when the foreclosed mortgage is a purchase money mortgage<sup>84</sup> or is by power of sale.<sup>85</sup> Other states

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<sup>75</sup> Brabner-Smith, *supra* note 9, at 722; Lifton, *supra* note 58, at 1950; Prather, *supra* note 6, at 432, 452; Washburn, *supra* note 7, at 854; Comment, *supra* note 64, at 42.

<sup>76</sup> See Tefft, *supra* note 24, at 590 (statutory rights of redemption made it difficult to perfect the purchaser's title in such a short period, and "almost invariably discouraged strangers who might otherwise have bid for the property."); Comment, *supra* note 64, at 39 (statutory right of redemption greatly discourages persons other than the mortgagee from bidding for the property).

<sup>77</sup> Madway, *supra* note 12, at 150; *see also* OSBORNE, *supra* note 20, § 335, at 703.

<sup>78</sup> Friedman, *supra* note 58, at 385-86; Madway, *supra* note 12, at 150.

<sup>79</sup> Madway, *supra* note 12, at 150; Washburn, *supra* note 7, at 916.

<sup>80</sup> *See generally* Vaughan, *supra* note 25, at 963-65; Washburn, *supra* note 7, at 855-901. Judicial relief, however, was very limited. Mere inadequacy of price was insufficient to overturn a foreclosure sale; to warrant judicial relief, the inadequacy had to be "gross," or "so extreme as to shock the conscience of the court," Washburn, *supra* note 7, at 862-63, or coupled with fraud or other misconduct. *See* Nelson, *supra* note 6, at 157; Vaughan, *supra* note 25, at 963-64; Washburn, *supra* note 7, at 862-63. A later profitable resale of the property by the mortgagee did not prevent the mortgagee from obtaining a deficiency judgment. *See generally* De Funiak, *supra* note 23; Nelson, *supra* note 6, at 157.

<sup>81</sup> *See* OSBORNE, *supra* note 20, § 335, at 704; OSBORNE, NELSON & WHITMAN, *supra* note 24, § 8.3, at 528; POWELL & ROHAN, *supra* note 26, ¶ 473, at 696.76(65)-(71); Lifton, *supra* note 58, at 1941; Madway, *supra* note 12, at 150.

<sup>82</sup> Madway, *supra* note 12, at 150; Washburn, *supra* note 7, at 843.

<sup>83</sup> *See* OSBORNE, *supra* note 20, § 335, at 705 & n.61 (Ark. Laws 1933, act 57, held unconstitutional in *Adams v. Spillyards*, 187 Ark. 641, 61 S.W.2d 686 (1933)); POWELL & ROHAN, *supra* note 26, ¶ 473, at 696.76(66) (North Dakota forbids any deficiency judgment on a note and mortgage executed after July 1, 1951).

<sup>84</sup> OSBORNE, NELSON & WHITMAN, *supra* note 24, § 8.3, at 530; Washburn, *supra* note 7, at 916-17.

<sup>85</sup> OSBORNE, NELSON & WHITMAN, *supra* note 24, § 8.3, at 529; Nelson, *supra* note 6, at 154; Washburn, *supra* note 7, at 917-18. For other statutory techniques for limiting deficiencies, *see* Nelson, *supra* note 6, at 154; Washburn, *supra* note 7, at 903-07, 917-30.

continue to allow deficiencies but require that they be calculated using the fair market value of the property rather than the foreclosure sale price.<sup>86</sup> Like the mortgage legislation of the 1820s, the Depression era antideficiency statutes have endured throughout mortgage foreclosure law, remaining as part of the statutory scheme some fifty years later, despite the many economic changes since their enactment.<sup>87</sup>

### C. The Present State of Mortgage Foreclosure Law in the United States

The preceding summary of the history of American mortgage foreclosure law suggests its present state. While specific methods used vary among the jurisdictions,<sup>88</sup> some generalizations emerge. First, foreclosure by public sale is the most prevalent method of foreclosure in this country.<sup>89</sup> Most states do not permit strict foreclosure.<sup>90</sup> The few jurisdictions which do allow strict foreclosure<sup>91</sup> restrict it to protect the mortgagor.<sup>92</sup>

The two principal methods of foreclosure by sale are judicial foreclosure and power-of-sale foreclosure.<sup>93</sup> With the latter

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<sup>86</sup> Nelson, *supra* note 6, at 154; Washburn, *supra* note 7, at 907-16; Comment, *supra* note 13, at 259. New York State's antideficiency legislation is of this type. Under the New York statute, if a mortgagee wishes to preserve the right to seek a deficiency judgment, he must request the judgment simultaneously with making a motion for an order confirming the foreclosure sale. N.Y. REAL PROP. ACTS LAW § 1371(2) (McKinney 1979). The mortgagee must file the motion for an order confirming the sale and the attendant motion for a deficiency judgment within 90 days of the foreclosure sale. *Id.* Upon a motion for deficiency judgment, the court determines the amount of the judgment, which is the amount due the mortgagee as of the date of the foreclosure sale, including interest, prior liens, costs of the sale, etc., less the higher of the property's sale price or its fair market value as determined by the court. *Id.* If the mortgagee does not move for a deficiency judgment, the proceeds of the sale are deemed to fully satisfy the mortgage debt. *Id.* § 1371(3).

<sup>87</sup> OSBORNE, NELSON & WHITMAN, *supra* note 24, § 8.3, at 528; Nelson, *supra* note 6, at 154; Washburn, *supra* note 7, at 843, 901.

<sup>88</sup> OSBORNE, NELSON & WHITMAN, *supra* note 24, § 7.165, at 466.

<sup>89</sup> *Id.* § 7.9, at 442.

<sup>90</sup> *Id.* § 7.10, at 443. Although in most jurisdictions strict foreclosure is not usually available to the mortgagee, it may be allowed under certain circumstances including actions to (1) cancel installment land contracts, (2) declare absolute deeds to be mortgages, and (3) cure a defective foreclosure in which an interested party was not joined. *Id.* § 7.10, at 444-45.

<sup>91</sup> Until recently, strict foreclosure was available in Vermont, Illinois, and Connecticut. Connecticut is now the only state to allow strict foreclosure by a mortgagee. COOPER-HILL & GREENBERG, *supra* note 30, at 235.

<sup>92</sup> For example, Illinois limited strict foreclosure to situations in which the property's value did not exceed the total amount owed the mortgagee, the mortgagee was willing to take the property in full satisfaction of the debt, and the mortgagor was insolvent. OSBORNE, NELSON & WHITMAN, *supra* note 24, § 7.10, at 443-44.

<sup>93</sup> *Id.* § 1.4, at 9; COOPER-HILL & GREENBERG, *supra* note 30, at 234. Foreclosure by

method, the sale is not judicially supervised.<sup>94</sup> Both methods require prior notice to the interested parties<sup>95</sup> and a public sale,<sup>96</sup> and each method allows the mortgagee to bid at the sale.<sup>97</sup> If the sale produces a surplus, the statute generally requires its distribution to junior lienors, with any balance going to the mortgagor.<sup>98</sup> Subject to any antideficiency protections,<sup>99</sup> the mortgagee usually can obtain as a deficiency judgment the difference between the amount paid at the foreclosure sale and the balance of the debt.<sup>100</sup>

Requiring a public sale and enacting statutory redemption laws and antideficiency measures have the common goal of protecting mortgagors' interests. The public sale, coupled with statutory redemption, is intended to protect the mortgagor's equity by producing the best possible price.<sup>101</sup> Antideficiency statutes are designed to protect the mortgagor from the double loss that results from los-

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judicial sale is available in every jurisdiction and is exclusively or generally used in 24 states. OSBORNE, NELSON & WHITMAN, *supra* note 24, § 7.11, at 446.

Power of sale foreclosure is available in most other states. *Id.* § 7.19, at 475. Maine is the only state in which neither foreclosure method is predominant. See Committee on Mortgage Law and Practice, *Cost and Time Factors in Foreclosure of Mortgages*, 3 REAL PROP. PROB. & TAX J. 413, 421 (1968).

<sup>94</sup> COOPER-HILL & GREENBERG, *supra* note 30, at 234-35; Madsen, *supra* note 12, at 329.

<sup>95</sup> OSBORNE, NELSON & WHITMAN, *supra* note 24, § 7.16, at 468, § 7.19, at 475-76. The notice requirements are generally less rigorous in power-of-sale foreclosures. *Id.* § 7.19, at 475.

<sup>96</sup> COOPER-HILL & GREENBERG, *supra* note 30, at 234-35; OSBORNE, NELSON & WHITMAN, *supra* note 24, § 1.4, at 9; Madsen, *supra* note 12, at 329.

<sup>97</sup> See *supra* note 58; see also Donaldson v. Mansel, 615 S.W.2d 799, 802 (Tex. Civ. App. 1980), *reh'g denied* (1981) (mortgagee may purchase at foreclosure sale he conducts under deed of trust); Moreland v. Marwich Ltd., 629 P.2d 1095, 1097 (Colo. Ct. App. 1981), *reh'g denied* (1981), *rev'd on other grounds*, 665 P.2d 613 (Colo. 1983) (en banc) (mortgagee can bid amount of debt and, if not seeking deficiency, need not bid fair market value).

<sup>98</sup> OSBORNE, NELSON & WHITMAN, *supra* note 24, § 7.31, at 519-21; see *infra* notes 150-51 and accompanying text.

<sup>99</sup> See *supra* notes 81-86 and accompanying text.

<sup>100</sup> OSBORNE, NELSON & WHITMAN, *supra* note 24, § 8.1, at 525.

<sup>101</sup> See *supra* notes 60-62 and accompanying text. Junior lienors also would benefit if a higher price were produced because they share in any amount generated at the sale in excess of the senior mortgage debt being foreclosed. See Durfee & Doddridge, *supra* note 6, at 829; Nelson, *supra* note 6, at 163. The junior mortgagee is left with only a personal claim against the mortgagor if the sale does not produce enough to satisfy his debt because the sale extinguishes the junior security interest. POWELL & ROHAN, *supra* note 26, ¶ 463, at 696.64-65 (junior mortgagee must be joined in foreclosure action); 10 G. THOMPSON, *supra* note 25, § 5172, at 187-88, 190 (although foreclosure sale purchaser receives title of mortgagor as of making mortgage, together with any infirmity upon the title, purchaser obtains by estoppel all junior interests). The junior mortgagee is further disadvantaged if he buys at the sale to protect his interest, in that he must pay cash for the property, thus increasing his investment. The senior mortgagee can bid up to the amount of his debt without parting with any cash. COOPER-HILL & GREENBERG, *supra* note 30, at 234; Durfee & Doddridge, *supra* note 6, at 840; Washburn, *supra* note 7, at 849.

ing his property to a mortgagee for less than its worth and facing a deficiency judgment based on that depressed price.<sup>102</sup> These statutory protections disregard the possibility that the mortgagee may purchase the property at the foreclosure sale, forego any claim to a deficiency and then quickly resell the property for enough both to pay off the debt balance and to make a profit.

Despite judicial recognition of such profitable resales,<sup>103</sup> courts have upheld both foreclosure sales and deficiency judgments.<sup>104</sup> In only one reported case has the mortgagor recovered the profit realized by a mortgagee who bought at foreclosure and quickly resold the property. In *Central Financial Services, Inc. v. Spears*,<sup>105</sup> the Supreme Court of Mississippi upheld an order compelling a mortgagee to account to the mortgagor for a profit the mortgagee realized on resale of the property. The mortgagee purchased the property at the foreclosure sale for \$1,458, the amount of the debt.<sup>106</sup> It then sold the property twelve days later to an unrelated third party for \$4,000, realizing a profit of \$2,481.<sup>107</sup> In an action by the mortga-

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<sup>102</sup> OSBORNE, NELSON & WHITMAN, *supra* note 24, § 8.3, at 528; Washburn, *supra* note 7, at 849-51, 889.

<sup>103</sup> See cases cited *supra* note 21.

<sup>104</sup> See *Smith v. Black*, 115 U.S. 308 (1885) (foreclosure sale upheld); *Thompson v. Maslia*, 127 Ga. App. 758, 195 S.E.2d 238 (1972) (same); *Gordon v. Harris*, 290 Mass. 482, 195 N.E. 744 (1935) (same); *Triplett v. Bridgforth*, 205 Miss. 328, 38 So. 2d 756 (1949) (same); *Haines v. Twelfth Ward Bank*, 162 A.D. 164, 147 N.Y.S. 254 (1914), *aff'd*, 220 N.Y. 751, 116 N.E. 1049 (1917) (deficiency judgment upheld); *Schultz v. Mead*, 29 N.Y. Sup. Ct. 203, 8 N.Y.S. 663 (1890), *aff'd*, 128 N.Y. 680, 29 N.E. 149 (1891) (same); *Allison v. Allison*, 88 Va. 328, 13 S.E. 549 (1891) (same); see also *Friedman*, *supra* note 58, at 385 (even before Depression, courts recognized that judicial sales failed to attract bidders).

Courts allowed profitable resales on the theory that the date of the foreclosure sale was the relevant date for measuring the rights of the parties, and either the foreclosure sale price or the fair market value on that date was the correct measure of the right to a deficiency. See *Washburn*, *supra* note 7, at 868, 873, 889-90 (courts refuse to use resale price as barometer of property value because of potential for distortion by extrinsic factors). Moreover, it was sometimes argued that the mortgagee who bought at the sale should be treated like a third-party buyer and should not be penalized because he later made a profitable resale of the property. See *id.* at 887, 890. As a result, even where a subsequent profitable resale occurred, deficiencies often were permitted and foreclosure sales upheld unless there was either gross inadequacy in the price obtained at foreclosure or a defect, such as fraud, in the foreclosure sale. See *Nelson*, *supra* note 6, at 157; *Washburn*, *supra* note 7, at 860-63; see also *Chemical Bank & Trust Co. v. Adam Schumann Assoc.*, 150 Misc. 221, 268 N.Y.S. 674 (Sup. Ct. 1934) (deficiency judgment set aside due to grossly inadequate foreclosure sale price); *Union Joint Stock Land Bank v. Knox County*, 20 Tenn. App. 273, 97 S.W.2d 842 (1936) (deficiency judgment overturned where mortgagee resold shortly after foreclosure for amount sufficient to cover deficiency).

<sup>105</sup> 425 So. 2d 403 (Miss. 1983).

<sup>106</sup> *Id.* The \$1,458 included foreclosure costs.

<sup>107</sup> *Id.* at 403-04. The mortgagee paid a \$30 judgment lien on the property and realized a profit of \$2,481.14. About four months later, the third party sold the property for a \$2,000 profit over their \$4,000 purchase price. *Id.* at 404.



gor to have the foreclosure sale set aside, the court deemed the \$2,481 "windfall" profit<sup>108</sup> realized by the mortgagee unjust and affirmed and modified the chancellor's order.<sup>109</sup> *Spears* is the only case<sup>110</sup> in which a court has granted relief by requiring the return of profits reaped by a mortgagee at the mortgagor's expense. Without that relief, the foreclosure sale in *Spears* would have produced the same result as strict foreclosure: an absolute exchange of the property for the balance of the debt, with no duty to account for the surplus value of the property.

The *Spears* court's finding that a profitable resale of mortgaged property by the mortgagee constitutes unjust enrichment is sound. Even in foreclosure, the mortgagor has a right to a fair price for his property. The production of a quick resale profit strongly suggests that the foreclosure sale did not produce a fair price. Since the report of the empirical study that follows demonstrates that the profitable resale in *Spears* is not an anomaly, it appears that our law of mortgage foreclosure is not working as intended and that prompt reform is necessary.

## II

### THE EMPIRICAL STUDY: METHODOLOGY—DATA GATHERING AND STATISTICAL ANALYSIS

The goal of this empirical study was to present a current and accurate picture of mortgage foreclosure and to measure the extent of acquisitions and subsequent profitable resales of foreclosed properties by mortgagees. The sample consisted of all mortgage foreclosure actions begun in Onondaga County, New York, during 1979 that culminated in a confirmed foreclosure sale.<sup>111</sup> One hun-

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<sup>108</sup> *Id.* at 405.

<sup>109</sup> *Id.* The chancellor had calculated the mortgagor's recovery based on the fair market value of the property, which he fixed at \$6,000. The Supreme Court of Mississippi reduced the recovery to the profit actually realized on resale. *Id.* See Comment, *Mortgages-Mortgagor's Remedies-Unconscionable Windfall from Resale of Security Immediately After Mortgagee's Purchase at Foreclosure Sale Gives Mortgagor a Right to Damages*, 53 Miss. L.J. 533, 535 n.12 (1983).

<sup>110</sup> *Spears* is the only case in which this relief has been granted as a matter of state law. In *Fitzgerald v. Cleland*, 650 F.2d 360 (1981), the First Circuit required the Veterans Administration to return a profit of approximately \$15,000 which it realized from the resale of the mortgagor's property approximately three months after acquiring it by strict foreclosure. Although the court felt it would be "unjust" for the creditor to retain this profit, *id.* at 361, its order requiring the return of the profit to the mortgagor was founded on the fact that both the federal statute and the Veterans Administration's own regulations lacked any authority for the VA to retain the surplus money. In the absence of any such authority, the court inferred an intent that ordinary property rules, which it interpreted to favor the debtor, should apply. *Id.* at 362.

<sup>111</sup> Although all of the foreclosure actions in the sample began in 1979, some of the foreclosure sales did not occur until 1980. The sample does not include foreclosure sales held during 1979 if the action was begun before 1979, nor does it include foreclo-

dred and eighteen such transactions were identified and examined. The year 1979 was chosen to allow sufficient time for accurate measurement of the resale of the foreclosed properties because a major part of the study involved reviewing the subsequent history of the properties after foreclosure.

All information used in the study was derived from the public record. Court and land records maintained by the Onondaga County Clerk contained data concerning foreclosures and subsequent histories of the foreclosed properties. The records of the County and City Assessment Offices showed whether the properties were single-family, two-family, multi-family residential, or commercial property.<sup>112</sup> Finally, the public index of bankruptcy filings maintained by the United States Bankruptcy Court in Utica, New York, was searched for each mortgagor in the study. Attempts to examine the relevant records of a number of the bank mortgagees in the study failed because the bankers who were approached refused to disclose any specific information concerning their foreclosures.<sup>113</sup>

### A. Data Gathering

The process of gathering the data was accomplished by the following seven steps.

#### 1. *Identification of All 1979 Foreclosure Actions*

Two index books maintained by the county clerk identified all foreclosure actions commenced during 1979 that resulted in a judgment of foreclosure and a foreclosure sale confirmed by the court.<sup>114</sup> From these indices, we found the names of the parties and the numbers of the court files.

#### 2. *Examination of Court Files*

After identifying the 118 completed foreclosures in the sample, we reviewed the court file for each foreclosure. Each file consisted of the pleadings from the initial Summons and Complaint through

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sure actions that did not culminate in a sale. See generally W. COCHRAN, *SAMPLING TECHNIQUE* (2d ed. 1963) (for background information on sampling).

<sup>112</sup> The assessment and real property tax records for all of Onondaga County except for the city of Syracuse are maintained by the Office of the Commissioner of Finance, Department of the Treasury, Onondaga County. Records for property located within the city of Syracuse are maintained by the Assessment Office for the City of Syracuse.

<sup>113</sup> The bankers interviewed in connection with the study declined to provide any documentary information or permit inspection of their records.

<sup>114</sup> The indices examined were entitled "Deposits With the County Treasurer" and "Lis Pendens Index." Although most foreclosures were listed in the Deposits book, some 1979 foreclosure actions were indexed only in the Lis Pendens volume.

the final Order Confirming Report of Sale.<sup>115</sup> The foreclosure files provided a wealth of information, including the terms of the original loan transaction, the description of the land involved, the amount due as of the foreclosure sale, the identity of the successful bidder, the amount bid, and a record of the surplus or deficiency generated by the sale.

### 3. *Deficiency Judgment Search*

The General Index to Civil Actions and the Judgment Docket showed whether the mortgagee had pursued a deficiency judgment.<sup>116</sup> These records also were examined to determine when such deficiency judgments were obtained and satisfied.

### 4. *Prior and Subsequent Histories of the Properties*

The Grantor, Grantee, Mortgagor, and Mortgagee Indices located the recorded deeds and mortgages relating to each foreclosed property. In each case, we reviewed the deed by which the mortgagor acquired the property, any mortgages on the property, and any deeds from subsequent resales of the property. These indices disclosed the dates of the acquisition and resale transactions, whether an existing mortgage had been assumed, or whether the property had been taken subject to a mortgage. Since most of the deeds recited only a nominal consideration, we calculated the true consideration based on the mandatory tax stamp.<sup>117</sup> These computations show the sale prices within \$250.<sup>118</sup>

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<sup>115</sup> The contents of a typical file included: Notice of Pendency of Action; Summons; Affidavit of Personal Service; Verified Complaint; Affirmation in Support of Motion for Appointment of Receiver; Order Appointing Receiver; Receiver's Oath; Receiver's Bond; Affidavit of Receiver; Affirmation in Support of Receiver's Accounting; Order Settling Receiver's Account; Order of Reference; Affirmation of Regularity; Referee's Oath; Referee's Report of Computation; Judgment of Foreclosure and Sale; Notice of Sale; Terms of Sale; Referee's Report of Sale; Order Confirming Report of Sale; and Affidavits of Notice.

<sup>116</sup> To obtain a deficiency judgment, the mortgagee must file a motion within 90 days of the foreclosure sale asking the court to enter that judgment. *See supra* note 86.

<sup>117</sup> At the time of most of the transactions in the study, the New York State real estate transfer tax was 55 cents per \$500 of consideration or any fraction thereof. N.Y. TAX LAW § 1402 (McKinney 1975) (amended 1983). Thus, in a transaction in which the true consideration was \$12,275, the tax imposed would be \$13.75 ( $\$12,275/\$500 = 24.55$ ). Rounding the fraction up to 25, the final computation is  $25 \times \$.55 = \$13.75$ ). Working backwards, a tax stamp of \$13.75 means the true consideration was between \$12,001 and \$12,500. The amount of the tax is stamped on the face of the deed at the time it is recorded.

<sup>118</sup> In order to minimize any distortion of the data, we took the midpoint of the range in each calculation of the true consideration. Transfer tax calculations on transactions occurring before May 1, 1983, did not include the amount of any mortgage the buyer assumed or took subject to, *id.*; accordingly, those amounts were added in where they occurred. In 1983 the tax was increased to \$2.00 per \$500 of consideration and the amount of an assumed or subject to obligation was no longer excluded from the tax

### 5. *Determination of Property Use*

We reviewed the County and City assessment records for each property and recorded the Property Type Classification Code for each. The detailed codes<sup>119</sup> were aggregated into the categories of single-family, two-family, multi-family residential, and commercial property for purposes of the later analysis.

### 6. *Bankruptcy of Mortgagor*

We searched the Public Index of the United States Bankruptcy Court located in Utica, New York, for the name of each defaulting mortgagor and the filing date of bankruptcy petitions, if any. Most Onondaga County landowners filing for bankruptcy would do so in the Northern District of New York, and their filings would be indexed in the Bankruptcy Court in Utica.<sup>120</sup>

### 7. *Special Cases*

Twenty-nine foreclosures in the sample were on mortgages insured by a government agency.<sup>121</sup> In each case the government agency paid the mortgagee the amount due on the mortgage debt and substantially all of the costs associated with the foreclosure proceeding<sup>122</sup> and then took over the mortgagee's position as to the

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base. N.Y. Tax Law § 1402 (McKinney Supp. 1984). These figures were used for any resales occurring after the May 1, 1983, effective date of the change. Thirteen cases in which the property was resold had to be excluded from the calculation of profits and losses on resale because the transactions were exempt from the real estate transfer tax, typically because the sale was to a government agency or a charity. N.Y. Tax Law § 1405 (McKinney 1975). This tax exemption made it impossible to determine the true consideration paid in these transactions. Accordingly, these 13 resales were not included in the calculation of the profits and losses on resale, *see infra* notes 167, 181, 187 and accompanying text. *See also infra* text accompanying note 177.

<sup>119</sup> More than 200 individual codes are listed in a pamphlet entitled *Property Type Classification Codes*, issued by the New York State Division of Equalization and Assessment (May 1980).

<sup>120</sup> The proper place to file for bankruptcy is determined by the judicial district in which the bankrupt is domiciled during the six months prior to filing. 11 U.S.C. § 11(a)(1) (1976), *repealed by* 11 U.S.C. § 109(a) (1982). For a bankrupt domiciled in Onondaga County, the proper place to file is the United States Bankruptcy Court in the Northern District of New York. Within the district, the most logical location is the court in Utica, New York. An occasional bankrupt might choose to file in the United States Bankruptcy Court in Rochester, New York, which also is located in the Northern District. The index maintained in Utica includes the Rochester filings.

<sup>121</sup> The three government insuring agencies involved were the Department of Housing and Urban Development, the Veterans Administration, and the Small Business Administration.

<sup>122</sup> *See* OSBORNE, NELSON & WHITMAN, *supra* note 24, § 11.2, at 654-57. Depending on the agency involved, the actual amount paid to the mortgagee might be slightly less than the debt balance. *Id.* § 8.11, at 555-56. For example, if a lender assigns the mortgage to the government, the Federal Housing Administration will pay 99% of the loan balance and handle the foreclosure process by itself; under the claim procedure used by

land and the debtor.<sup>123</sup>

In three cases, buyers subsequently resold property purchased at the foreclosure sale in smaller units. In these cases, we averaged the individual resale dates to calculate the time between foreclosure and later resales.

## B. Data Analysis

After gathering the data, we constructed and analyzed a data base using the Statistical Analysis System (SAS) program package<sup>124</sup> on an IBM 4341 computer. Statistical summary measures, such as the mean, median, variance, and standard deviation of the observations were calculated.<sup>125</sup> Confidence intervals and hypothesis tests were used for some portions of the analysis.<sup>126</sup> The important characteristics of each foreclosure and resale were manually plotted on a map of Onondaga County to show any geographic patterns evident in the sample.

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the Veterans Administration, a ceiling is imposed on the payment to the mortgagee. In most of the cases in the sample involving a government insurer, however, it appears that the mortgagee recovered most of its investment through the insurance policy.

<sup>123</sup> In 13 cases the government agency assumed the mortgagee's position by taking an assignment of the mortgagee's successful bid at the foreclosure sale. In the remaining 16 cases, the mortgagee purchased the property at foreclosure and promptly deeded it to the insuring agency. There is no functional difference between these methods. The government agency took over the position of the mortgagee under either method.

<sup>124</sup> See generally SAS INSTITUTE INC., SAS USER'S GUIDE: BASICS (1982).

<sup>125</sup> The mean is the average of all values in a given group. The median is the middle value in the group. See D. BARNES, STATISTICS AS PROOF: FUNDAMENTALS OF QUANTITATIVE EVIDENCE 75-76 (1983). The median is not easily influenced by a few very high or low values in the series and is thus a truer measure of the "central" value than the mean. The mean is a better measure of the population average because it takes all values into account. The variance and standard deviation are measures of how far the values are distributed from the mean within the sample. *Id.* at 77-80.

<sup>126</sup> A confidence interval is a statistical tool for predicting the characteristics of a universe based on a sample drawn from that universe. It is expressed as a range within which the true mean of the value in the universe is likely to fall, together with a statement of the likelihood that the true mean does fall within that range. *Id.* at 235-36.

The confidence intervals presented in this Article were calculated using the normal approximation method, except when its confidence fell below a level where it could be guaranteed (for example, where its confidence was 94.5% when 95% was sought). In cases where the observed number was too small to calculate an accurate normal approximation with the given sample size, the exact Biometrika charts were used. See E. PEARSON & H. HARTLEY, I BIOMETRIKA TABLES FOR STATISTICIANS (3d ed. 1966).

A hypothesis test is a statistical method of assuring that observed differences are larger than simple random fluctuations which one would expect even if there were no true differences. Hypothesis tests were obtained from either corresponding confidence intervals or from chi-square statistics. See generally E. DUDEWICZ, INTRODUCTION TO STATISTICS AND PROBABILITY (1976).

## III

## RESULTS OF THE EMPIRICAL STUDY

In this section the results of the data gathering and analysis discussed above are presented in narrative and graphic form. In addition, a table setting forth much of the data is presented in Appendix A. The following section uses these results to analyze the workings of the mortgage foreclosure process and to support proposals for reform.

## A. Summary of Results

Some of the major results of the study are broadly presented here, followed by the detailed results on which they are based.<sup>127</sup>

Mortgagees purchased in about three-quarters of the foreclosure sales; they resold the property within a year or less in seventy percent of the cases where they bought at foreclosure. Mortgagees made profits in about half of the cases in which they purchased and quickly resold the foreclosed properties. Two-thirds of these profits were between \$2,000 and \$10,000. More than seventy percent of these profits were made on the resale of single-family homes. More than half the profits made by mortgagees who acquired and resold single-family homes were greater than \$4,000.

In the other half of their resales, mortgagees sustained losses, two-thirds of which were between \$2,000 and \$15,000. Taking profits and losses together, the average of all foreclosure transactions produced an average loss to mortgagees of almost \$14,000. The entire foreclosure process resulted in the mortgagee being made whole<sup>128</sup> in forty-four percent of the cases.

Third parties bought at foreclosure about one-quarter of the time.<sup>129</sup> Some third parties may have bought foreclosed single-family homes as residences, rather than as investments. There are contradictory indications about whether third parties use foreclosure as an opportunity to speculate and turn quick profits; there is some evidence they may buy the best properties, leaving the abused or neglected properties for mortgagees to purchase.<sup>130</sup>

More than half of the foreclosure sales to third parties, but only

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<sup>127</sup> Throughout this report, all percentages have been rounded off to the nearest whole number; observations and calculated values have generally been rounded off to the nearest \$100.

<sup>128</sup> The mortgagee is made whole when it recovers the full amount of the debt balance and any additional costs to which it is entitled by law, either at the foreclosure sale or by a later resale of the property.

<sup>129</sup> This is significantly more than had previously been reported. Other authorities report that the mortgagee is generally the only bidder. *See supra* note 12.

<sup>130</sup> *See infra* notes 147-49 and accompanying text.

one sale to a mortgagee, produced a surplus. More than ninety percent of the sales to mortgagees left deficiencies, compared with deficiencies left in thirty-nine percent of the sales to third parties.

Even though eighty percent of the foreclosure sales left deficiency amounts, many for substantial sums of money,<sup>131</sup> mortgagees made virtually no attempt to obtain deficiency judgments. In about fifteen percent of the cases involving a deficiency, the mortgagor had declared bankruptcy, and the mortgage debt probably was discharged.

## B. Detailed Findings

### 1. *Details of the Sample*

No particular geographic pattern emerged among the 118 properties. The foreclosures were almost evenly distributed between those located within Syracuse, the largest city in the county, and those in the suburban and rural areas surrounding the city.<sup>132</sup>

Eighty-nine of the foreclosed loans were made by banks and similar institutional lenders, twenty by individual lenders, and the remaining nine by other kinds of lenders, such as corporate employers facilitating employee relocations. In twenty-two percent of the cases, the original transaction was a purchase money loan made by the seller of the property. Fifty-nine percent of the loans were made for the acquisition of the property by lenders other than the sellers. The remaining nineteen percent of the loans were made subsequent to the acquisition of the property by the mortgagor.<sup>133</sup>

Eighty-nine of the 118 loans were conventional loans without any government agency involvement after default or foreclosure. The remaining twenty-nine loans were insured by government agencies: twenty-one by the Department of Housing and Urban De-

<sup>131</sup> In at least some of these cases, the circumstances indicated that mortgagees probably could have obtained a substantial deficiency judgment. *See infra* notes 158-62 and accompanying text.

<sup>132</sup> Thirty-seven percent of the county's population and three percent of its land area are located in Syracuse. U.S. BUREAU OF THE CENSUS, COUNTY AND CITY DATA BOOK 382, 760 (1983).

<sup>133</sup> This last category includes construction loans, home-improvement loans, and loans made for other purposes that were secured by an interest in the real estate. The following table sets out the distribution of the 118 foreclosures by type of lender and type of loan:

	Bank or Other Institutional Lender	Individual Lender	Other Type of Lender	Total
Acquisition Loan by Third Party	65	1	3	69
Acquisition Loan by Seller of Property	3	18	5	26
Nonacquisition Loan	21	1	1	23
TOTAL	89	20	9	118

velopment, six by the Veterans Administration, and two by the Small Business Administration. The government agency paid off each insured mortgagee under the terms of the agreement, then took over the loan and the property from the mortgagee.<sup>134</sup>

The original loans ranged from \$4,200 to \$1,800,000, with the median loan amount being \$20,400. Seventy-eight of the properties were single-family residences, thirteen were two-family residences, and six were multi-family residences. The remaining twenty-one properties were devoted to a variety of commercial uses, such as parking garages, apartment and office buildings, stores, and riding stables.

## 2. *The Foreclosure Action: Before the Sale*

The length of time between the loan and the default that triggered the foreclosure action ranged from as little as three weeks to as long as twenty-one years, with the median time being a little more than three years. A preponderance of the defaults occurred during the first seven years of the loan; very few defaults occurred during the eighth through thirteenth years, and the balance of defaults were spread out from the fourteenth year onward<sup>135</sup> (see Figure 1).

The time periods between the date of default and the commencement of the foreclosure action were generally rather short. More than seventy percent of the actions were begun within ten months of default. In three cases, this period ran as long as two or three years. In one case more than five years elapsed after the default before the mortgagee finally instituted foreclosure proceedings.

The time between the foreclosure action and the entry of the judgment was generally short. In sixty-four percent of the cases, this period was six months or less, and in ninety-two percent the judgment was entered within a year of the initiation of the lawsuit.

A receiver was appointed to manage the property prior to the sale in seven foreclosures. In five cases only a small amount of interim income was left to apply to the debt after deducting the receiver's fee.<sup>136</sup> In two instances the receiver's operation of the property produced substantial sums of money (\$72,000 and

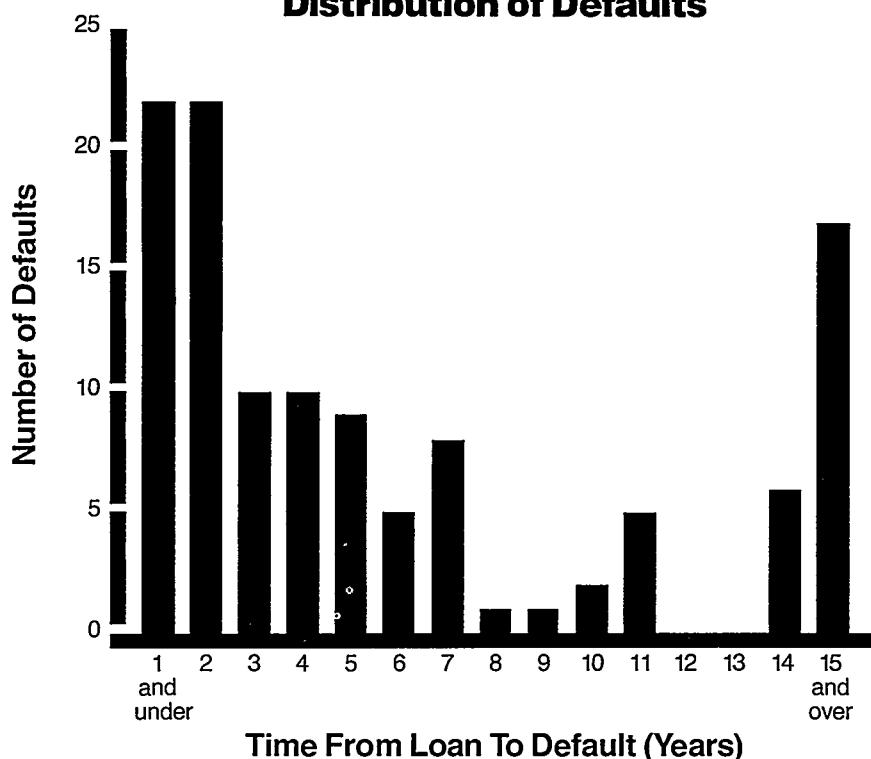
<sup>134</sup> The government agency assumes the mortgagee's position in these cases. Accordingly, this study treats a later resale by the government agency as if the mortgagee had made it. The profits and losses realized on resales by these government insurers are also reported separately. See *infra* notes 187-89 and accompanying text.

<sup>135</sup> The borrowers' lack of accumulated equity in the first five to seven years of an amortizing loan may have caused the large number of defaults during the early years of the loans. See *supra* note 61.

<sup>136</sup> See N.Y. REAL PROP. ACTS. § 1371(4) (McKinney 1979) (providing that a court



Figure 1  
**Distribution of Defaults**



\$106,000), which were used to reduce the outstanding debt balance.<sup>137</sup>

### 3. *At the Foreclosure Sale*

a. *General.* Following entry of the foreclosure judgment, statutory provisions require the mortgagee to advertise and give notice of the sale.<sup>138</sup> The court files show that the mortgagees in the sam-

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shall direct that "all moneys remaining in the hands of a receiver . . . after payment of the receiver's fees . . . shall be paid to the plaintiff . . .").

<sup>137</sup> The properties involved were a parking garage and a small shopping center. Each was in the receiver's care for about two years. The receiver's profit reduced the debt balances in these two cases by about 8% and 5% respectively.

<sup>138</sup> During the study period, the applicable law required the mortgagee to publish the date and place of the sale as well as a description of the property in a newspaper published in the county where the property was located. N.Y. REAL PROP. ACTS. § 231 (McKinney 1979) (amended 1984). The statute required the mortgagee to publish this information at least once in each of the four weeks preceding the sale. *Id.* § 231(2)(a). If the property was located outside an incorporated village or a city, the law also required the mortgagee to post sale notices in three public places in the town where the property was located. *Id.* § 231(2)(b). If the sale was to be held in a town or city other than where the property was located, the law required mortgagees to post notices in the town or city where the sale was to be held. *Id.* All notices had to be posted at least 28 days before the sale. *Id.*

ple complied with the statutes. Typically, the mortgagees posted notice of the sale in several public places (such as the County Courthouse and Town Hall) and advertised the sale in the legal notices of a local newspaper for four successive weeks before the sale.

Foreclosure sales are generally held at the County Courthouse in Syracuse.<sup>139</sup> No record is kept of the identity of the bidders or the amounts bid. The Referee's Report of Sale discloses only the name of the successful bidder and his bid. The report also includes the amount the mortgagor owed the lender as of the date of sale, including accrued interest and any other items.

The amounts owed to the lenders on the sale date varied widely, ranging from as little as \$500 to more than \$2.2 million. Three-quarters of these amounts were \$36,000 or less. Additional amounts due to lenders for costs, advertising, sheriff's and referee's fees, unpaid real estate taxes, costs of securing the property, and attorney's fees<sup>140</sup> generally involved small dollar amounts. The median additional amount was approximately \$1,200, and the highest was \$6,600.<sup>141</sup>

The sum of the debt balance, accrued interest, and additional amounts due the mortgagee, added to any surplus amount paid to the mortgagor or junior lienors, represents the lender's total investment in the property as of the foreclosure sale date. The calculations of a surplus or a deficiency amount<sup>142</sup> and of a mortgagee's profit or loss on resale are based on this total investment amount. Mortgagees' total investments<sup>143</sup> as of the foreclosure sale ranged from \$1,000 to more than \$2.2 million, with the median amount falling at about \$23,000.

b. *Foreclosure Sale Prices.* The winning bids at the foreclosure

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<sup>139</sup> The notice must state the location of the sale. See *supra* note 138.

<sup>140</sup> N.Y. REAL PROP. ACTS. § 1371 (McKinney 1979), provides that costs and disbursements of the action, including the Referee's fee are included in the deficiency judgment. The Sheriff's fee, and the costs of advertising and posting the required notices are covered by this statute. The mortgage agreement usually provides for the mortgagor's liability for real estate taxes and for the mortgagee's attorney's fees in connection with the foreclosure action. See, e.g., I. STEINMAN, 1 NEW YORK REAL PROPERTY FORMS 3-27 to 3-28 (2d ed. 1984) (providing for mortgagor's liability for mortgagee's attorney's fees).

<sup>141</sup> These additional amounts were more significant when measured as a percentage of the debt balance. The median percentage was 7%.

<sup>142</sup> This amount is shown on the Referee's Report of Sale as "Surplus or Deficiency." The surplus or deficiency amount is not necessarily the same as the amount that could be obtained in a deficiency judgment. See *supra* note 86 (discussion of deficiency judgment); *infra* notes 158-62 and accompanying text (discussion of deficiency amounts and judgments).

<sup>143</sup> The total investment sometimes exceeded the original amount loaned because of the addition of accrued but unpaid interest and additional expenses and the small reduction in principal in the early years of an amortizing loan. See *supra* note 61.

sales<sup>144</sup> ranged from a low of \$1 to more than \$500,000. It is difficult to evaluate the fairness of these foreclosure sale bids because when the mortgagee is the sole bidder and does not intend to pursue a deficiency,<sup>145</sup> he often may enter a nominal bid as a matter of convenience. Mortgagees' bid amounts may thus be depressed because of poor attendance at foreclosure sales. Whether this theory is valid or not, sales to third parties often commanded fairer prices than those to mortgagees. More than half of the sales to third parties, but only one sale to a mortgagee, generated a surplus.<sup>146</sup>

c. *Identity of Buyers at Foreclosure Sale.* In the sample of 118 foreclosure sales, the mortgagee bid successfully in 91 cases, or seventy-seven percent of the total, and third parties bought in 27 cases, or twenty-three percent of the total.<sup>147</sup> The distribution of types of properties purchased by mortgagees and third parties corresponded roughly to the distribution of properties in the sample as a whole. Third parties acquired slightly more than their proportionate share of single-family homes, suggesting that some third parties use foreclosure sales for home-buying rather than for investment purposes.

Third-party purchasers at foreclosure sales typically borrowed from lenders other than the foreclosing mortgagee. Only one of the twenty-seven third-party buyers obtained financing from the foreclosing mortgagee.

The twenty-seven third-party cases involved twenty-six different buyers. While not conclusive, this fact suggests the absence of third-party speculators at foreclosure sales.<sup>148</sup> There is an indication to the contrary, however; in eight cases in which third parties bought at foreclosure and resold for a profit, the foreclosed property was a single-family home, and the mortgagors defaulted more than ten years after acquiring the loan. This fact suggests that these third-party purchasers may have been on the alert for homeowners who were forced into foreclosure by some unfortunate circumstances after building up considerable equity in their properties.<sup>149</sup>

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<sup>144</sup> In many cases these may have been the only bids, but, as indicated *supra* text following note 139, no record is kept of losing bidders at the sale.

<sup>145</sup> The mortgagees in the sample rarely pursued deficiencies. See *infra* notes 158-62 and accompanying text.

<sup>146</sup> See *infra* notes 152-57 and accompanying text.

<sup>147</sup> A 95% confidence interval, see *supra* note 126, predicts that the mortgagee will be the buyer in 68% to 84% of the mortgage foreclosures from which this sample is drawn.

<sup>148</sup> This tentative conclusion is strengthened by our observation that a few names appeared repeatedly in the Grantor and Grantee indices. Apparently, a small group of people are active traders of real estate in Onondaga County and indeed may be speculating in real property. Their activity is not prominent at foreclosure sales, however.

<sup>149</sup> Some of these third-party purchasers could have been privy to nonpublic information, such as illness or death in a neighboring family, and that family's sudden departure, as well as knowledge of the value of that neighbor's property.

d. *Deficiencies and Surpluses.* Deficiencies or surpluses are calculated by subtracting the balance of the debt, the accrued interest, and the additional amount due to the lender on account of the foreclosure from the successful bid at the foreclosure sale. If the sale price exceeds these deductions, a surplus remains and is distributed to junior lienors<sup>150</sup> or paid to the mortgagor.<sup>151</sup> If the deductions exceed the price, a deficiency amount results.<sup>152</sup> If the amount bid at foreclosure equals the amount due the lender, neither a surplus nor a deficiency results.

The sales left deficiency amounts in 94 of the 118 foreclosures, or about eighty percent of the total. A deficiency was much more likely to result when the mortgagee, rather than a third party, was the buyer at foreclosure. Ninety-two percent of the sales to mortgagees left deficiencies, as opposed to thirty-nine percent of the sales to third parties (see Figure 2). Moreover, the deficiencies in the third-party cases tended to be relatively small: about half amounted to less than \$5,000, and only one exceeded \$18,000.<sup>153</sup> The deficiency amounts left by mortgagee purchases ranged from less than \$1 to more than \$2 million.<sup>154</sup>

Only one sale to a mortgagee produced a surplus, and that surplus was only \$1,400. In contrast, fifty-four percent of the sales to third parties generated surpluses to be paid to the mortgagor or junior lienors.<sup>155</sup> Two-thirds of these surpluses amounted to more than \$5,000.<sup>156</sup> Third parties bid the exact amount due to the mortgagee in two cases, leaving neither a deficiency nor a surplus; mortgagees did the same in six cases.<sup>157</sup>

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<sup>150</sup> N.Y. REAL PROP. ACTS. § 1354(3) (McKinney Supp. 1984).

<sup>151</sup> *Id.* § 1361 (McKinney 1979).

<sup>152</sup> This amount is not necessarily the correct measure of a deficiency judgment, *see supra* note 86.

<sup>153</sup> The deficiency amount in that case was \$375,000. In sales to third parties, the median deficiency amount was about \$4,700.

<sup>154</sup> In many of these cases, however, the mortgagee did not lose the amount of the deficiency because upon a later resale of the property, the mortgagee recovered its entire investment and, in some cases, made a profit. *See infra* notes 179-80 and accompanying text.

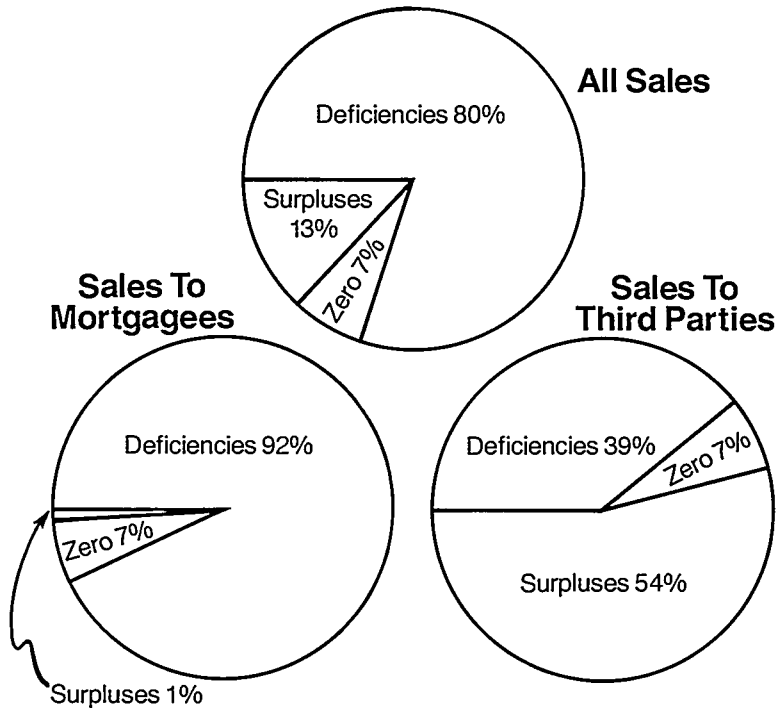
<sup>155</sup> A hypothesis test, *see supra* note 126, shows that at the 5% level of significance, there is a greater probability of a surplus when a third party is the buyer than when the mortgagee is the buyer.

<sup>156</sup> Sales to third parties generated surpluses of more than \$1,000 in 80% of the cases.

<sup>157</sup> When a third party bids the exact amount due at the foreclosure sale, the mortgagee is made whole. When the mortgagee bids the exact amount due, the mortgagee may or may not be made whole, depending on the amount received from later disposition of the property. If the mortgagee resells the property for less than his total investment, he will sustain a loss on the transaction, even though no deficiency amount was left when the property was sold in foreclosure proceedings. The mortgagee sustained a

Figure 2

### Distribution Of Deficiencies, Surpluses, And Zero Balances At Foreclosure Sales



e. *Pursuit of Deficiencies—Bankruptcy of Mortgagors.* Eighty per cent of the foreclosure sales left deficiency amounts. These amounts are not necessarily the proper measure of a deficiency judgment; under New York law a deficiency judgment is measured by deducting the greater of the property's fair market value or the foreclosure sale price from the amount owed the lender.<sup>158</sup> Although the fair market value might often exceed the foreclosure sale price, deficiency judgments, often for substantial amounts,<sup>159</sup> probably could have been obtained in many of those instances where a disinterested third party bought for less than the amount due,<sup>160</sup> as well as in many cases where a mortgagee bought and later

loss upon subsequent disposition of the property in two of the six cases in which a mortgagee bid the exact amount due.

<sup>158</sup> See *supra* note 86.

<sup>159</sup> Leaving aside cases where the mortgagor's bankruptcy explains the nonpursuit of a deficiency, see *infra* note 162 and accompanying text, the deficiency amounts were more than \$5,000 in 40% of the remaining cases and more than \$50,000 in 8% of the remaining cases. The highest amount was \$2.2 million.

<sup>160</sup> A purchase by an unrelated third party is a reliable indication of the regularity of the foreclosure sale and the fairness of the purchase price, Washburn, *supra* note 7, at

resold for a loss.<sup>161</sup> Nevertheless, of the ninety-four studied cases in which the foreclosure sale left a deficiency amount, the mortgagee obtained a deficiency judgment in only one case, and in that case the judgment was not satisfied.

The mortgagees may not have pursued deficiency judgments in fifteen cases because their mortgagors filed for bankruptcy at about the same time as the foreclosure, suggesting that the deficiency would have been discharged in bankruptcy. In seventeen other cases, the mortgagor had filed for bankruptcy either long before the loan was made or long after the foreclosure. Although these bankruptcies would not discharge the unpaid mortgage debt, they may be an indication of the anticipated difficulty of collecting the deficiency. Bankruptcy explains the nonpursuit of deficiencies in no more than a third of the cases, however.<sup>162</sup>

#### 4. *After Foreclosure: Resale, Retention, Profit and Loss*

a. *Retention of Property and Speed of Resale.* The study concluded between four and five years after the 118 foreclosure sales.<sup>163</sup> During this period the foreclosure sale buyers resold 100 of the properties, or about eighty-five percent. Fewer third-party buyers than mortgagee buyers sold within this time frame: almost one-third of the third-party buyers retained ownership at the close of the study, as opposed to eleven percent of the mortgagees<sup>164</sup> (see Figure 3). In two-thirds of the cases in which third parties retained ownership, the properties involved were single-family homes, again suggesting that some third parties purchase homes at foreclosure sales as residences rather than as investments.

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888, and thus indicates that the deficiency amount could have been reduced to a deficiency judgment even under the fair market value statute, *see supra* note 86.

<sup>161</sup> Because most resales occurred within a year after the foreclosure sale, *see infra* notes 165-66 and accompanying text, the resale price is presumably a reasonable measure of the fair market value. A resale for less than the amount of the debt would therefore suggest that the deficiency amount approximates the deficiency judgment which the mortgagee could have obtained.

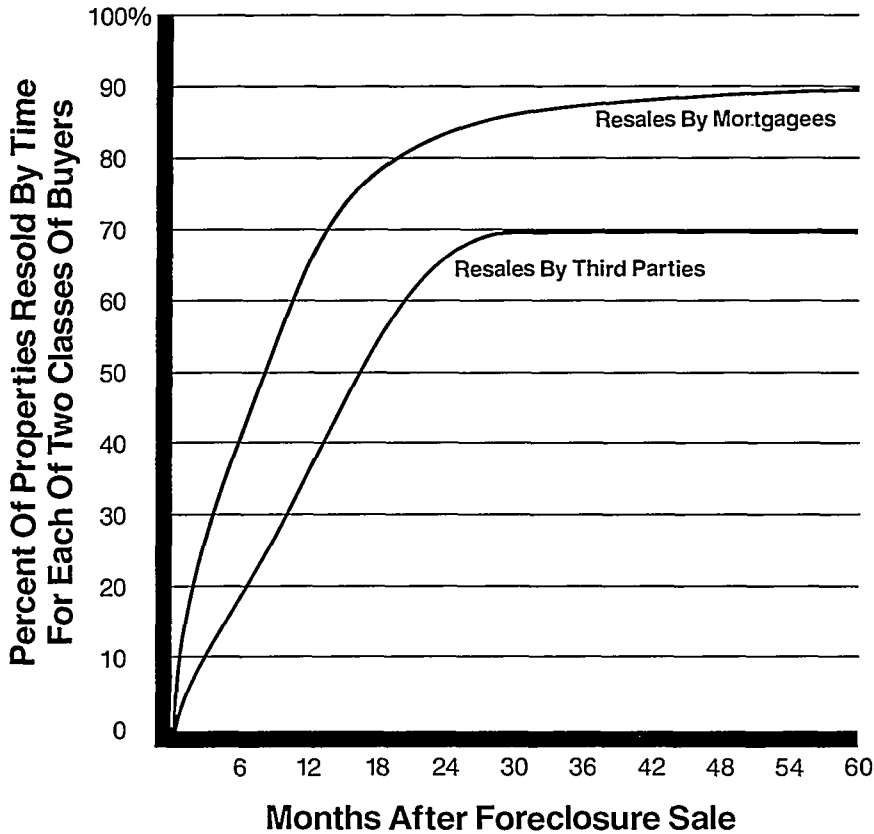
<sup>162</sup> In addition to the cases involving bankruptcy, another third of the deficiency cases may be explained by the fact that the deficiency amount was less than \$5,000. The high cost of collecting the debt may prevent many mortgagees from pursuing such a small amount. However, because the mortgagee may have calculated the bid amount purely for convenience and in an amount unrelated to the value of the property, *see supra* text accompanying notes 145-46, the deficiency amounts may in some cases understate the amount that could have been reduced to a deficiency judgment. Moreover, after factoring out the bankruptcy cases, 40% of the remaining deficiency amounts were more than \$5,000 and 8% were more than \$50,000.

<sup>163</sup> *See supra* note 3.

<sup>164</sup> One explanation for this difference may be that, with limited exceptions, statutes prohibit both state-chartered and national banks from owning real property for more than five years unless they need it for their operations. N.Y. BANKING LAW § 98(3) (McKinney Supp. 1983) (repealed 1984); 12 U.S.C. § 29 (1982).

Figure 3

### Resale And Retention Of Purchased Properties



Third parties who sold their properties during the period of the study sold more slowly than did mortgagees<sup>165</sup> (see Figure 3). In the first six months after foreclosure, forty-seven percent of the mortgagee resales had taken place, as opposed to twenty-one percent of those of third-party buyers. Within a year, almost eighty percent of the mortgagees who disposed of their properties had done so, while only fifty-eight percent of the third parties had done the same.<sup>166</sup> Regardless of who bought at foreclosure, about ninety-

<sup>165</sup> At the 5% level of statistical significance, a hypothesis test, *see supra* note 126, establishes that the probability of resale within one year after acquisition at foreclosure is not the same for mortgagees and third parties.

<sup>166</sup> Based on the sample, we can state with individual 95% confidence, *see supra* note 126, that in 60% to 80% of all cases, a mortgagee buyer will resell property acquired at foreclosure within one year, while a third party buyer will resell within one year in 15% to 50% of all cases.

five percent of the resales that occurred by the close of the study took place within two years of the foreclosure sale.

b. *Profit and Loss on Resale: Mortgagees.* Mortgagees purchased at 90 of the 118 foreclosure sales and resold within the period of the study in 81 cases. We could not calculate the resale price in nine resales because the transactions were exempt from the real estate transfer tax.<sup>167</sup> Excluding those nine cases, the mortgagees recovered their investment<sup>168</sup> and made a profit in thirty-five cases, or about half of the nonexempt resales. The mortgagees sold for less than their investment, and thus sustained losses, in thirty-seven instances. The profitable sales and the losing sales were scattered geographically throughout the county, although there were more profitable sales than losing ones in the suburban areas outside the city of Syracuse.<sup>169</sup>

The profits mortgagees realized on resale generally ranged from less than \$1,000 to \$24,000,<sup>170</sup> with a median profit of \$5,080. Approximately eleven percent of the profits fell below \$1,000; about twenty-five percent of the profits were between \$2,000 and \$5,000, and forty percent were between \$5,000 and \$10,000 (see Figure 4). In the one case in which the mortgagee purchased at foreclosure and generated a surplus (of \$1,400), the mortgagee subsequently resold the property at a \$2,750 profit. Twenty-five of the thirty-five cases in which the mortgagee made a profit on resale involved single-family homes. More than half the profits made on single-family homes exceeded \$4,000 and almost one-quarter exceeded \$8,000.<sup>171</sup>

Mortgagees usually realized their profits within a relatively short time after foreclosure. More than forty percent of the profits

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<sup>167</sup> See *supra* note 118.

<sup>168</sup> The mortgagee's investment is the sum of the debt balance due on the date of foreclosure, including accrued interest, the additional amounts due to the mortgagee, see *supra* note 140 and accompanying text, and the amount of any surplus the mortgagee has paid to the mortgagor or junior lienors. See *supra* notes 98, 150-51 and accompanying text.

<sup>169</sup> See *supra* note 132 and accompanying text.

<sup>170</sup> There was one striking exception to this range: the mortgagee netted about \$648,000 on resale. The documents in the court file suggest that this transaction involved a large construction loan and a default bond. Presumably, after the mortgagor's default, the mortgagee collected on the bond and completed the project. The extraordinarily large "profit," therefore, probably did not reflect the underlying value of the property at the time of foreclosure but represented a significant additional investment made by the mortgagee and the bonding company after the mortgagor's default.

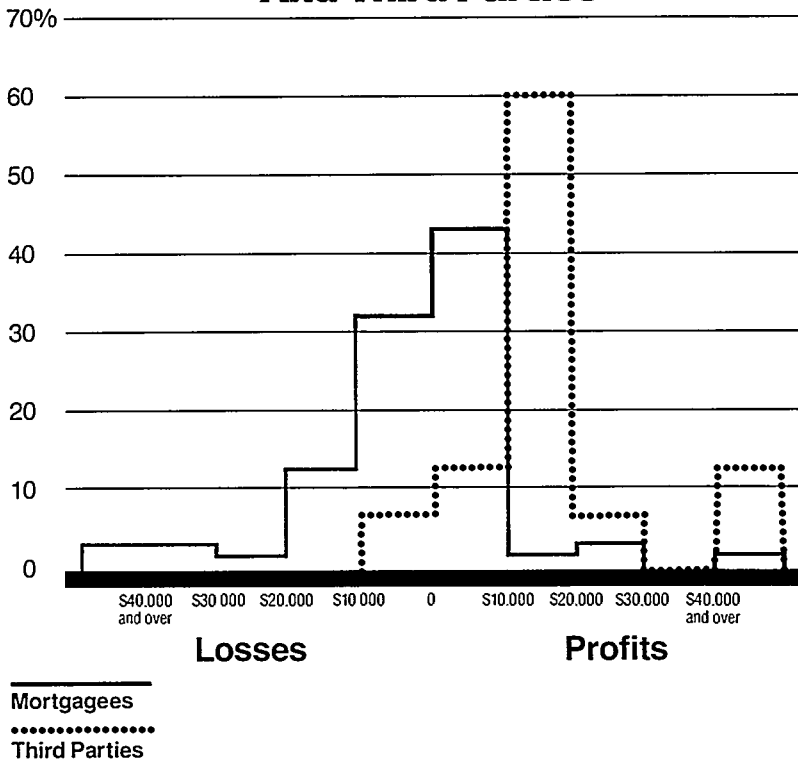
<sup>171</sup> Where the mortgagee buys a single-family home at a foreclosure sale, we can predict with 95% confidence that, in 5% to 25% of these cases, the mortgagee will resell within one year for a profit of at least \$4,000. See *supra* note 126 for an explanation of confidence intervals.



resulted from resales that took place within six months of foreclosure, and more than eighty-five percent were realized within one year of foreclosure.<sup>172</sup> Although in many instances the dollar amounts of these profits would not be of major significance to a large lending institution, a surplus of \$5,000 or \$10,000 might be very important to a financially distressed homeowner.<sup>173</sup> When the return is measured as a percentage of their investment, mortgagees who held these properties for short time periods frequently realized annualized rates of return<sup>174</sup> ranging from fifty-six percent to more

Figure 4

### Distribution Of Non-exempt Resales: Profit And Loss For Mortgagees And Third Parties



<sup>172</sup> Based on the sample, we can state with 95% confidence (see *supra* note 126 for a discussion of confidence intervals) that when the mortgagee is the buyer at the foreclosure sale, in 9% to 26% of these cases, the mortgagee will resell the property within one year of foreclosure and will realize a profit of at least \$4,000 on the resale.

<sup>173</sup> These amounts might also be important to a junior lienor, who would have shared in them had they been generated as a surplus at the foreclosure sale. See *supra* notes 98, 150 and accompanying text.

<sup>174</sup> The annualized rate of return is calculated as follows: the profit is divided by the mortgagee's investment in the property to produce a rate of return on the transaction. Thus, a \$2,008 profit on an investment of \$25,742 would represent an 8% return if the

than one thousand percent.<sup>175</sup>

Mortgagees resold the properties for less than their total investment and sustained losses in about half of the nonexempt resales. These losses ranged from a few hundred dollars to \$1.4 million.<sup>176</sup> Almost two-thirds of the losses fell between \$2,000 and \$15,000, with a median loss of \$6,900. As with the profits, the losses were realized soon after foreclosure. Fifty percent of the losses were within the first six months, seventy-three percent within one year, and more than ninety percent within two years. Although the likelihood of profit or loss on resale did not hinge on the type of property involved, single-family home sales generated slightly more profits than losses, and commercial property sales showed the greatest extremes of both profit and loss.

Mortgagees made profits in about half the resales and incurred losses in the other half, but their total losses on resale outweighed their gains. The median loss on resale was about \$1,800 greater than the median profit, and the largest losses substantially exceeded the largest profits. If all the profits and losses were netted, mortgagees would show an average loss on these resales of slightly more than \$13,000.

If we consider all foreclosure transactions, rather than only those involving nonexempt resales, the mortgagees in the sample sustained even greater losses. Three reasons explain these losses. First, the exempt resales,<sup>177</sup> in which the purchase price could not be determined, were more likely to produce losses than profits. These sales were usually tax-exempt because local government units or charities purchased the properties, and neither were likely to pay

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investment was held for exactly one year. If, however, the same \$2,008 profit is earned but the investment is held for less than a year, the rate of return must be increased to reflect that shorter holding period. For example, when the investment is held for 38 days, the 8% return calculated earlier must be adjusted by a factor of 9.6, calculated by dividing the number of days in a year (365) by the number of days the investment is held (38 days, in this example), yielding an annualized rate of return of 77%.

<sup>175</sup> The following table shows selected rates of return for a few of the resales by mortgagees:

Profit	Investment in Property	Time Between Foreclosure Sale and Resale (days)	Profit/ Investment in Property	Annualized Rate of Return
\$8,524	\$46,226	118	.18	56%
\$3,288	\$23,462	83	.14	61%
\$2,008	\$25,742	38	.08	77%
\$6,526	\$22,224	126	.29	84%
\$2,750	\$ 4,000	117	.69	215%
\$1,797	\$ 3,953	41	.45	400%
\$23,798	\$ 8,952	91	2.66	1,067%

<sup>176</sup> The \$1,400,000 loss involved a commercial property and was the only one of this magnitude. The next largest loss was \$87,000.

<sup>177</sup> See *supra* note 118.

much for foreclosed properties. Second, because no mortgagee collected a deficiency judgment,<sup>178</sup> the deficiency amounts remaining in eleven of the cases involving third-party buyers also represented losses to the mortgagees involved. When these deficiency amounts are combined with the profits and losses on resale, the average mortgagee sustained an overall loss of almost \$14,000. Finally, the nine properties which mortgagees purchased at foreclosure and were still holding four to five years later may also produce losses, if the mortgagee must eventually resell them for nominal amounts.

On the whole, mortgagees in the study lost more money than they gained on foreclosures, but the foreclosure sale made the mortgagor whole in forty-four percent of all cases in the sample.<sup>179</sup> Based on the sample, we can expect that mortgagees will be made whole in thirty-five to fifty-three percent of all foreclosures.<sup>180</sup>

c. *Profit and Loss on Resale: Third Parties.* Approximately two-thirds of the third parties who purchased at foreclosure resold within the period of the study; they sold profitably in fourteen of the fifteen resales in which the resale price could be determined.<sup>181</sup> The profits from twelve of those fourteen resales were between \$7,000 and \$23,000.<sup>182</sup> The only loss amounted to \$2,750 (see Figure 4). Thus, third parties were much more likely than mortgagees to make a profit on resale.<sup>183</sup> This suggests that the third-party buyers were snapping up the most attractive properties at foreclosure,<sup>184</sup> leaving the depreciated and neglected parcels for the mortgagees to buy in order to protect their investments.<sup>185</sup>

d. *Insured Mortgages: Resale, Retention, Profit, and Loss.* In twenty-nine cases a government agency took over the foreclosed property from the mortgagee and paid off the mortgagee under the insurance contract.<sup>186</sup> Twenty-one of these cases involved single-

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<sup>178</sup> See *supra* notes 158-62 and accompanying text.

<sup>179</sup> See *supra* note 128. At the 5% level of statistical significance, a hypothesis test indicates that the probability that the mortgagee would be made whole was the same whether the mortgagee or a third party was the buyer at the foreclosure sale.

<sup>180</sup> We can make this statement with 95% confidence; see *supra* note 126.

<sup>181</sup> Four resales by third parties occurred in transactions exempt from the imposition of the real estate transfer tax, and because we calculated the resale prices from this tax, none of these resale prices could be determined. See *supra* note 118.

<sup>182</sup> The two other resales, each of a single-family home, generated profits of \$42,000 and \$54,000, respectively.

<sup>183</sup> In comparison, mortgagees resold at a profit in about half of the cases. See *supra* text accompanying notes 168-71. This discrepancy is made more striking because even when third parties paid enough at the foreclosure sale to generate a surplus, the third parties resold at a profit in two-thirds of these cases (10 out of 15).

<sup>184</sup> An alternative explanation is that third parties were more likely than mortgagees to invest substantial sums in improving properties acquired at foreclosure.

<sup>185</sup> See De Funiak, *supra* note 23, at 411; Prather, *supra* note 6, at 455.

<sup>186</sup> See *supra* notes 121-23 and accompanying text.

family homes, seven were two-family homes, and one was a commercial property.

After assuming the mortgagee's position, the insuring agency resold the properties in twenty-five cases. Of the eighteen cases with known prices,<sup>187</sup> eight resales generated profits,<sup>188</sup> and ten resulted in losses.<sup>189</sup> The profits ranged from about \$1,800 to about \$8,000; the losses ranged from \$2,200 to about \$18,000. More than three-quarters of the resales by government agencies occurred within one year of foreclosure.

#### IV

##### ANALYSIS, IMPLICATIONS, AND PROPOSALS FOR REFORM

The results of the empirical study suggest that foreclosure by sale is not achieving its objectives of providing competitive bidding and fair prices,<sup>190</sup> while preserving mortgagees' rights to collect deficiencies.<sup>191</sup> Instead, it often functions as a meaningless ceremony whereby the mortgagee exchanges the property for the debt, then retains any surplus generated through a profitable resale, takes any loss on an unprofitable disposal of the property, or if the property is not resold, absorbs the deficiency owed by the mortgagor. None of these results is desirable. On the one hand, the mortgagee who keeps the surplus deprives the mortgagor of a benefit that belongs to him and that our system clearly intends him to have.<sup>192</sup> On the other hand, the failure of the mortgagee to collect deficiencies, or his absorption of losses on unprofitable resales, may increase the cost of credit.

Because the present system of foreclosure by sale causes these unintended results, a number of reforms should be considered. First, the present foreclosure by sale process should be modified so that when a mortgagee buys a property at its own foreclosure sale, holds it for a short period of time, and then resells it for a profit, the mortgagor will receive the profit. Either judicial process or statute can achieve this result. Second, the foreclosure by sale process should be reformed to bring it closer to achieving its underlying goals of attracting interested bidders and producing fair prices, to reduce deficiencies and perhaps yield surpluses. If these goals can-

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<sup>187</sup> Seven resales were exempt from the real estate transfer tax. Thus, we could not determine their resale prices. See *supra* note 118.

<sup>188</sup> The Department of Housing and Urban Development had six profitable resales, the Veterans Administration had one, and the Small Business Administration had one.

<sup>189</sup> Nine losses were on properties insured by the Department of Housing and Urban Development and one loss was on a Veterans Administration property.

<sup>190</sup> See *supra* notes 60-65 and accompanying text.

<sup>191</sup> See *supra* note 58.

<sup>192</sup> See *supra* notes 60-61 and accompanying text.

not be achieved, then perhaps we should abandon the public-sale process as a costly waste of time and money. Finally, the reasons mortgagees fail to pursue deficiencies should be investigated. If it is possible to do so without compromising other societal goals, mortgagees should be aided in reducing foreclosure losses.

#### A. Foreclosure by Sale as Strict Foreclosure

In many cases the mortgagee is the buyer at the foreclosure sale, and the statutory process operates as the functional equivalent of strict foreclosure.<sup>193</sup> The purchasing mortgagee exchanges the property for the debt and is free to dispose of it. The mortgagee typically resells the property fairly quickly and, in about one-half of the cases studied, profitably.<sup>194</sup> Although these profits are probably not important to a large financial institution,<sup>195</sup> they are clearly significant to a beleaguered homeowner. The profit, which the mortgagee retains, may fairly be characterized as the mortgagor's accumulated equity in the property. Even if the mortgagee resells at a loss, the statutory foreclosure sale process resembles strict foreclosure. In these cases, the mortgagee absorbs the loss and does not collect the appropriate deficiency amount from the mortgagor. Thus, whether the mortgagee resells at a profit or at a loss, the current process produces the precise results that foreclosure by sale was intended to prevent.<sup>196</sup>

Mortgagees are supposed to be able to obtain and collect judgments for deficiencies in appropriate cases.<sup>197</sup> If mortgagees cannot

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<sup>193</sup> Some cases in which a third party buys at foreclosure may arguably be analogous to strict foreclosure; if the third party quickly resells the property at a profit, he unjustly reaps the surplus that should have gone to the mortgagor. If a third party buys, and there is an uncollected deficiency, then the mortgagee receives less than it was entitled to. However, when third parties buy at foreclosure sales, there are more surpluses, fewer deficiencies, *see supra* notes 153-57 and accompanying text, and fewer fast resales of the foreclosed property than when mortgagees purchase at foreclosure; *see supra* notes 164-66 and accompanying text, suggesting that such sales are far less abusive than those to mortgagees. *See also infra* notes 205-06 and accompanying text.

<sup>194</sup> About half of the mortgagees in the study who bought at foreclosure resold quickly at a profit. *See supra* text accompanying notes 168-72. Some of these profits may be attributable to additional investment in the property by the mortgagee. It appears unlikely, however, that many institutional lenders would regularly increase their investment in foreclosed properties by doing extensive renovations or major repair or reconstruction work because their business is loaning money, not investing in real estate.

<sup>195</sup> The rates of return, however, can be startlingly high. *See supra* notes 174-75 and accompanying text.

<sup>196</sup> *See supra* notes 59-65 and accompanying text.

<sup>197</sup> *See POWELL & ROHAN, supra* note 26, ¶ 462, at 696.50 ("Traditionally, in the United States foreclosure has connoted a deficiency judgment, that is, a judgment collectible out of the personal assets of the mortgagor for that part of the basic obligation not realized on the sale of the mortgaged land interest.") (footnote omitted); *see also supra* note 58.

collect these deficiencies, at least they have an opportunity to protect themselves against these losses by adjusting the cost and availability of credit. However, when mortgagee-buyers resell at a profit, homeowners are powerless to prevent the unjust appropriation of the equity in their properties.<sup>198</sup> The forfeiture inherent in this situation prompted the creation of the equity of redemption 300 years ago<sup>199</sup> and the substitution of foreclosure by sale for strict foreclosure 180 years ago.<sup>200</sup> The original goals of foreclosure by sale are as pertinent today as they were then. If experience shows that the public sale process does not achieve those goals, then that process should be changed.

Lenders probably will resist any change in the statutory process, arguing that overall, losses on foreclosures exceed gains<sup>201</sup> and that, thus, they should be permitted to retain the occasional gain to offset greater losses. This argument is not convincing. First, while mortgagees may as a class sustain net losses on foreclosures, many mortgagees achieve net profits. More importantly, each mortgage transaction is independent of all others; a lender should not be allowed to make up a loss on one transaction by unfairly retaining a profit on a separate and unrelated transaction.

Lenders might also argue that the interest rates they charge incorporate not only the anticipated losses, but the prospect of occasional profits,<sup>202</sup> and that the cost of credit would rise if they were not allowed to retain those profits. The numbers and amounts of these profits probably are not large enough to significantly affect the lending practices of major institutions. Nevertheless, it is inappropriate to reduce interest rates generally, at the expense of a relatively small number of financially distressed homeowners. In this connection it is worth reemphasizing that the drafters of our foreclosure by sale statutes never intended lenders to receive these profits.<sup>203</sup>

Under the existing foreclosure by sale process mortgagees re-

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198 Similarly, junior mortgagees who must pay cash and invest additional sums in the property to protect their investment, *see supra* note 101, often have no practical way to protect their interest in any potential surplus.

199 *See supra* notes 33-36 and accompanying text.

200 *See supra* notes 58-65 and accompanying text.

201 *See supra* notes 177-79 and accompanying text. Mortgagees may also argue that the gains reported in this Article are illusory, perhaps because of additional investments made after foreclosure, *see supra* note 194 and *infra* note 254, or because additional unsecured loans had been made to the defaulting mortgagors. This Article evaluates and draws conclusions only from the available empirical data.

202 This position would be inconsistent with that taken by bankers contacted in connection with this study, who uniformly maintained that foreclosing mortgagees never made profits on foreclosures. *See supra* note 19 and accompanying text.

203 Mortgagees' retention of these profits, which represent the increased value of the

tain profits from resale that they should return to mortgagors. There is no reason to distinguish between profits realized on a resale and a surplus produced at a foreclosure sale. In either case, the profit should be returned to the mortgagor. However, this general principle should be subject to a number of qualifications:

(a) Only mortgagees who purchase at foreclosure, and not third parties, should be required to account to the mortgagor for a profitable resale. First, mortgagees enjoy an advantage<sup>204</sup> at the foreclosure sale because they control the sale and can bid up to the amount of the debt without expending any cash;<sup>205</sup> third parties must pay for properties they buy with out-of-pocket dollars. Second, mortgagees have a preexisting relationship with their mortgagors, which they should not be permitted to exploit; third parties who buy at foreclosure do so in an arms-length transaction vis-a-vis the mortgagor. The study shows a much greater likelihood of a fair price and a surplus, and a far lesser likelihood of a deficiency or a quick resale when a third party, rather than the mortgagee, is the buyer at foreclosure.<sup>206</sup> Finally, in order to preserve the advantageous results associated with foreclosure sales to

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land, was one of the principal evils of strict foreclosure that foreclosure by sale was intended to prevent. See *supra* text accompanying notes 60-61.

Lenders may make two other arguments against a reform directed at forcing them to relinquish profits realized on resales after foreclosure. First, they may argue that they deserve compensation because their investment in the property continues until the resale, depriving them of the opportunity to invest their funds elsewhere. This argument fails, however, because the purchase of the property at foreclosure is a further investment, which may produce an extremely high rate of return. See *supra* notes 174-75 and accompanying text. A lender who is receiving a return of more than 50% is hardly in a position to complain that he was prevented from investing the same funds at 14%.

A second argument against reform that lenders might proffer is that part of the profit realized on resale is attributable to the inflation in the value of the property during their holding period and, therefore, does not belong to the mortgagor. Since real estate is not ordinarily subject to extremely rapid shifts in value, it seems unlikely that mortgagees who hold these properties for short time periods, see *supra* notes 165-66 and accompanying text, are entitled to a significant share of the profits on this basis. Nevertheless, reformers might further consider the idea of apportioning that percentage of resale profits attributable to inflation between foreclosure and resale.

<sup>204</sup> See *United States v. Stadium Apartments, Inc.*, 425 F.2d 358, 368 (9th Cir. 1970) (Ely, J., dissenting) ("Unfortunately, this expectation was frustrated by reason of the immense advantages favoring the mortgagee at the sale. First, it was unnecessary for the mortgagee to raise and expend any cash up to the amount of the unpaid debt. Second, there would not often be an interested outside buyer, or junior lien holder with cash, at the precise time of the sale. Thus, the senior mortgagee was assured of being almost always the only bidder at the sale."); Nelson, *supra* note 6, at 151, 169; Washburn, *supra* note 7, at 849.

<sup>205</sup> See Nelson, *supra* note 6, at 151.

<sup>206</sup> In many cases where a third party made a profit on resale, in fact, a surplus had been generated at the foreclosure sale. See *supra* note 183.

third parties they should be allowed to retain the profits from resale. Forcing third parties to relinquish resale profits would dampen their interest in purchasing at foreclosure sales; instead, their participation should be encouraged in order to produce fair prices and surpluses.

(b) Mortgagees should only be required to return profits from resale of owner-occupied residential properties, and not from the resale of commercial or rental properties.<sup>207</sup> Many profitable resales involved single-family homes. These homeowners were probably the least knowledgeable about their rights, the most financially harmed by foreclosure, and the most in need of protection.<sup>208</sup> Commercial borrowers should have the knowledge and resources to protect themselves, even during foreclosure.<sup>209</sup>

(c) Mortgagees should only be required to return profits on those resales made within one year after foreclosure. The longer the mortgagee holds the property after foreclosure, the more likely he is to invest additional money in it or incur additional costs due to holding it. When a profitable resale occurs within a year after the foreclosure sale, the profit made on the resale is less likely to be attributable to action on the mortgagee's part than to the accumulated equity of the homeowner. Using the limit of one year for this rule would greatly curtail the unjust results presently found because the study indicates that more than eighty-five percent of the mortgagees' resale profits were made within a year after foreclosure.<sup>210</sup>

(d) Mortgagees should be required to return only the actual profits on the resale and should be entitled to keep the portion of the proceeds required to cover legitimate expenses associated with holding or reselling the property<sup>211</sup> or to compensate them for any amounts invested in the

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<sup>207</sup> See Lifton, *supra* note 58, at 1942 (emphasizing "unsophisticated position and . . . weaker bargaining power" of owner-occupied residential property owners as distinguished from commercial or rental property owners).

<sup>208</sup> *Id.* at 1942; Madway & Pearlman, *A Mortgage Foreclosure Primer: Part III: Proposals for Change*, 8 CLEARINGHOUSE REV. 473, 475 (1974) ("in a significant number of cases, especially involving low-income homeowners, either through inadvertence or lack of knowledge," homeowners will allow mortgagees to take strict foreclosure of their homes).

<sup>209</sup> People who run small businesses may suffer from the same lack of knowledge and power as homeowners and may need protection in their dealings with mortgagees.

<sup>210</sup> See *supra* note 172 and accompanying text.

<sup>211</sup> These expenses might include real estate taxes, attorney's fees, and brokerage commissions incurred after the foreclosure action concludes.



property between foreclosure and resale.<sup>212</sup>

One method of implementing this policy of returning the mortgagee's profits on resale to the mortgagor would be to handle profitable resales on a case-by-case basis. The traditional equity jurisdiction of courts handling foreclosure actions gives them broad discretion in fashioning appropriate remedies.<sup>213</sup> For example, as in *Spears*,<sup>214</sup> the court might simply order the mortgagee to return the profit made on resale to the mortgagor. This result is supported by a number of existing legal theories, such as unjust enrichment or the constructive trust remedy.<sup>215</sup>

A judicial solution to this problem is feasible but has some drawbacks. Many mortgagors will neither know about the new right, nor be aware of its applicability to their own situation.<sup>216</sup> Moreover, until a well-developed body of case law exists, each court would apply its own standard in such cases.<sup>217</sup> Although such flexibility might be beneficial,<sup>218</sup> both mortgagors and mortgagees would suffer from inconsistent decisions during the developmental stages of the law.

An alternative to the judicial approach is a statutory solution. A statute could require mortgagees who buy at foreclosure and subsequently resell the property within a year to submit a detailed report of the transaction to the mortgagor and to the court granting the foreclosure. The report would include details of the resale,<sup>219</sup> addi-

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<sup>212</sup> The effects of inflation might be taken into account if they proved significant. See *supra* note 203.

<sup>213</sup> See Washburn, *supra* note 7, at 855-56; OSBORNE, *supra* note 20, §§ 317-18.

<sup>214</sup> Central Fin. Servs., Inc. v. Spears, 425 So. 2d 403 (Miss. 1983) (holding that mortgagee's winning bid at foreclosure sale was inadequate when mortgagee resold foreclosed property within 12 days at a price two and one-half times bid; mortgagee compelled to return surplus to mortgagor). See *supra* notes 105-10 and accompanying text for a more complete discussion of the case.

<sup>215</sup> See RESTATEMENT OF THE LAW OF RESTITUTION §§ 124, 125, 160 (1937); BLACK'S LAW DICTIONARY 1353, 1377 (rev. 5th ed. 1979).

<sup>216</sup> Mortgagors would have to monitor the resales of their foreclosed properties to discover whether the resale triggered the right to bring such an action. Monitoring might require repetitive examinations of public records which few people are trained to understand.

<sup>217</sup> Return of the mortgagee's profit on resale might be appropriate in a case where it would be "impossible to state [the price paid at the foreclosure sale] to a man of common sense without producing an exclamation at the inequality of it." Federal Credit Co. v. Boleware, 163 Miss. 830, 835, 142 So. 1, 2 (1932) (when holder of conventional sales contract suing for balance due after resale of truck had become purchaser at foreclosure sale, evidence of fraud in sale insufficient to raise jury question).

<sup>218</sup> Judicial flexibility would prevent mortgagees from attempting to circumvent the law. For examples of some of these potential attempts, see *infra* notes 220-22 and accompanying text.

<sup>219</sup> These facts include the resale price, date of resale, identity of the buyer, and index numbers to the Deed and Mortgage Books recording the documents substantiating the resale transaction.

tional costs incurred or investments made since foreclosure, and any profit made. The profit, less these adjustments, would be required to be returned to the mortgagor. The law could enforce the requirement that the mortgagee report and account for any profits by imposing financial or licensing penalties on noncomplying lenders.<sup>220</sup> Mortgagees might attempt to circumvent this rule by simply structuring their transactions to fall slightly outside the one year period. Most profitable resales, however, would probably fall within one year<sup>221</sup> and few mortgagees would risk losing money on a later resale merely to gain a relatively small profit.<sup>222</sup>

This statutory reporting requirement would place new burdens on mortgagees, but because a reselling mortgagee would have all the facts necessary to complete the report, the obligation would not be excessively costly or time-consuming. Requiring mortgagees to fill out a standardized reporting form would be a small price to pay to reduce the injustice of mortgagees retaining profits that belong to mortgagors.

### B. Improving the Foreclosure Sale

The study found that sales to third parties more successfully achieve the goals underlying foreclosure by sale than do sales to mortgagees. Third-party purchases result in fewer deficiencies and offer a greater prospect of a surplus than purchases by mortgagees.<sup>223</sup> Although the study indicates that third-party participation correlates with a more successful sale, we should interpret this finding with care. We cannot conclude that third-party participation necessarily caused the higher prices paid at those sales. Some evidence suggests that third parties tend to buy at foreclosure only when the property is particularly attractive<sup>224</sup> and that mortgagees (who must buy, if no one else does, to protect their investments)<sup>225</sup> are left with properties that have depreciated because of market forces, neglect, or abuse. Further study is needed to determine what role the attractiveness of the property itself, as opposed to knowledge about the availability of the property, plays in determin-

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<sup>220</sup> Other methods of enforcement might include requiring a provision in every mortgage giving the mortgagor the right to profits from the resale or granting the mortgagor a statutory lien on the mortgaged property to secure the right to a resale profit.

<sup>221</sup> In the sample, 80% of the resales by mortgagees occurred within a year, *see supra* note I66 and accompanying text.

<sup>222</sup> Mortgagees also might seek to avoid the consequence of such a new statute by utilizing dummy corporations as third parties to buy on their behalf at foreclosure sales. If such conduct seemed likely to thwart the intent of the proposal, the law could empower courts to grant extraordinary relief to mortgagors to prevent injustice.

<sup>223</sup> *See supra* notes I53-57 and accompanying text.

<sup>224</sup> *See supra* note 184 and accompanying text.

<sup>225</sup> *See supra* note 185 and accompanying text.

ing third-party participation in foreclosure sales.<sup>226</sup>

If studies indicate that more active participation by third-party buyers would produce more successful foreclosure sales, then the procedures of those sales should be improved to encourage more third parties to attend and enter into spirited, competitive bidding. Third parties may not be actively participating in foreclosure sales for several reasons. In contrast to the mortgagee, who can bid up to the amount of the debt without making any new investment of cash,<sup>227</sup> a third-party bidder must pay the full amount of his bid in cash shortly after the sale.<sup>228</sup> This requirement may hinder third parties in obtaining financing<sup>229</sup> and thus may exclude those third parties who lack sufficient cash to purchase without borrowing. Third-party buyers also must forgo the usual amenities associated with a real estate purchase. For example, they do not deal with the seller face to face,<sup>230</sup> nor can they shop around or reflect upon the transaction. Some buyers who might otherwise be interested may shy away from the swift and sudden<sup>231</sup> nature of the foreclosure sale.

Lack of notice about foreclosure sales may effectively exclude some third parties from bidding. The notices required by the typical foreclosure statute do not attract the attention of the general public;<sup>232</sup> people in the market for a home are unlikely to consult the small-print legal advertisements located in the back pages of the newspaper.<sup>233</sup> Moreover, if third parties cannot inspect foreclosed properties before the sale, they will not obtain sufficient information

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<sup>226</sup> Such an inquiry, which is beyond the scope of this Article, might include an on-site inspection of foreclosed properties at the time of the foreclosure sale. An on-site inspection would aid in determining whether third parties were purchasing only the best properties, leaving the depreciated properties for mortgagees to buy.

<sup>227</sup> See, e.g., *United States v. Stadium Apartments, Inc.*, 425 F.2d 358, 368 (9th Cir. 1970) (Ely, J., dissenting); COOPER-HILL & GREENBERG, *supra* note 30, at 234; Durfee & Doddridge, *supra* note 6, at 840; Nelson, *supra* note 6, at 151; Washburn, *supra* note 7, at 849.

<sup>228</sup> 10 G. THOMPSON, *supra* note 25, § 5168, at 162; Washburn, *supra* note 7, at 849.

<sup>229</sup> An ordinary home loan might require as long as two months for approval. One commentator has observed that "[m]ost real estate buyers are not accustomed to all-cash purchases." Lifton, *supra* note 58, at 1936-37.

<sup>230</sup> The buyer often wants the opportunity to ask questions about the property. See Lifton, *supra* note 58, at 1937 (maintaining that most purchasers of real estate need face-to-face negotiation in order to achieve deals which take into account their economic and tax needs).

<sup>231</sup> See *id.* (arguing that nature of "forced" public foreclosure sales makes it difficult to find buyers other than mortgagees).

<sup>232</sup> See Washburn, *supra* note 7, at 896 (identifying ineffectiveness of notice in attracting potential buyers as major cause of price inadequacy in foreclosure sales).

<sup>233</sup> See Nelson, *supra* note 6, at 151; Tefft, *supra* note 24, at 590. Both commentators suggest that the general public is even more unlikely to be aware of such notices when the notices appear in legal newspapers.

to make an informed judgment about property value.<sup>234</sup>

A few basic requirements could ameliorate many of these defects in the public sale process. Improving the advertisement and notice requirements to alert more people to foreclosure sales would be a fairly simple matter. Mortgagees could advertise foreclosures in the same manner as ordinary real estate; specifically, the advertisement could use simple language to describe the property,<sup>235</sup> rather than couching the description in arcane legal language.<sup>236</sup>

<sup>234</sup> See Nelson, *supra* note 6, at 152 (arguing that mortgagors about to lose their property are reluctant to cooperate in allowing inspection of property even though inspections may generate greater third-party interest and, hence, more spirited bidding and higher prices).

<sup>235</sup> See *id.* at 163 (suggesting use of "normal commercial descriptive and pictorial advertising").

<sup>236</sup> A typical newspaper advertisement, giving notice of the impending foreclosure sale of a single-family home, is instructive. The classified section of a Syracuse newspaper published the following advertisement in connection with the "Wilson" foreclosure. See *supra* note 1 and accompanying text. In the newspaper, the advertisement is closely set, in six-point type, in a single column one and three-eighths inches wide and six inches long.

#### NOTICE OF SALE

STATE OF NEW YORK, SUPREME COURT, COUNTY OF ONONDAGA, "OLD LINE SAVINGS BANK," Plaintiff, vs. "THOMAS D. WILSON," et al., Defendants, Index No. 79-289, Pursuant to a judgment of foreclosure and sale granted on July 13, 1979, and entered in the above-entitled action in the Onondaga County Clerk's Office on the 18th day of July, 1979, I, the undersigned Referee in said judgment named, will sell at public auction at the first floor lobby on the west side of the Court House in the City of Syracuse, New York, on August 23, 1979, at 10:15 o'clock in the forenoon of that day the following described premises: "ALL THAT TRACT OR PARCEL OF LAND, situate in the Town of Marcellus, County of Onondaga and State of New York, being part of Farm Lot No. 14 in said Town and more particularly described as Lot No. 4555 of Limeledge Estate Section B, according to a map thereof made by Ronald F. Linderman, L.S., dated September 10, 1973, and filed in the Onondaga County Clerk's Office December 3, 1973 as Map No. 5291. The above premises are also more particularly described as follows: ALL THAT TRACT OR PARCEL OF LAND, with the buildings and improvements thereon erected, situate in the Town of Marcellus, County of Onondaga and State of New York, being part of Farm Lot No. 14 in said Town, described as follows: BEGINNING at a point in the centerline of Limeledge Road which point [sic] is 519.93 feet from the southeast corner of Limeledge Estate Tract, Section B, which southeast corner is 1789.5 feet from the centerline of the Old Seneca Turnpike; thence N. 82 degrees 38' 25" W. 351.02 feet to a point; thence N. 6 degrees 08' 41" E. 160.0 feet to a point; thence N. 82 degrees 38' 25" E. 354.47 feet to a point in the centerline of Limeledge Road, thence S. 7 degrees 22' 50" W. 159.96 feet along the centerline of Limeledge Road to the point and place of beginning. Subject to the rights of the public in and to Limeledge Road as it now exists as shown on the above-described tract map. Further, subject to easements, covenants and restrictions of record."

DATED: July 18, 1979

MICHAEL BYRNE, ESQ.

REFeree

Street Address of Property to be foreclosed: 4555 Limeledge Road,

and could appear with other real estate advertising, rather than in the back of the classified section. Increasing the amount of time between the first notice and the sale date and between the sale and the time when the bidder must pay for the property would afford third parties more time to seek financing both before and after the sale. In addition, this would allow third parties time to inspect the property; mandating that the property be available for this purpose is another logical requirement.

Other possibilities exist for improving the sale, perhaps more onerous to mortgagees, but possibly more conducive to generating higher prices. The foreclosure sale could be changed to more closely resemble an ordinary retail real estate sale,<sup>237</sup> rather than a forced auction sale. Because such an approach might be inappropriate for some properties, a statute could allow the court to require mortgagees to obtain an independent appraisal before authorizing a public sale. If the appraisal significantly exceeded the amount owed, the court would establish the appraised amount as an upset price.<sup>238</sup> If neither the mortgagee nor a third party bid the appraised amount at foreclosure, the court would then order the mortgagee to place the property on the retail market for a reasonable time,<sup>239</sup> using ordinary business practices to sell the property. Typically, this would involve employing a real estate broker. Changing the foreclosure sale from a forced, all-cash sale at the courthouse to an ordinary retail sale, including a broker, probably would attract

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Marcellus, New York.  
P16706

Syracuse Post-Standard, Aug. 14, 1979. Recasting this advertisement to resemble more closely those used in ordinary sales of real estate could encourage substantially greater public interest. For example, it might read as follows:

FORECLOSURE SALE

MARCELLUS — Lovely three bedroom ranch home; new kitchen, fireplace, hardwood floors. Best offer over \$52,000 takes it. Call Old Line Savings Bank at 423-9999 to arrange an appointment to see this property located at 4555 Limeledge Road, Marcellus.

<sup>237</sup> See Nelson, *supra* note 6, at 163-65 (advocating appointment of "truly independent" trustee who would have 90-day period after rendering of foreclosure judgment in which to sell property by customary "commercial means," including use of brokers and advertising); Washburn, *supra* note 7, at 937, 941 (endorsing the Uniform Land Transactions Act's foreclosure provisions).

<sup>238</sup> Although this technique is seldom used, it is "part of the inherent judicial power to control the foreclosure process." Washburn, *supra* note 7, at 883; see also Vaughan, *supra* note 25, at 964. Some state statutes currently require the use of an appraisal to establish an upset price. See, e.g., CONN. GEN. STAT. ANN. §§ 49-25, -28 (West Supp. 1984); LA. CODE CIV. PROC. ANN. arts. 2723, 2771 (West 1961). For a discussion of these and other statutes, see Madsen, *supra* note 12, at 349-50; Washburn, *supra* note 7, at 903-04.

<sup>239</sup> Perhaps a period of no longer than three to six months would be appropriate for this purpose.

more bidders,<sup>240</sup> which, in turn, would significantly increase the sale price. If mortgagees implemented these practices, they would be entitled to the cost of the appraisal, the interim interest expense, and the brokerage commission.<sup>241</sup>

Further study and experimentation may show whether significant modifications of the foreclosure sale process will heighten public interest and increase prices. This study demonstrates that, in many cases, the foreclosed property's value exceeds the foreclosure sale price.<sup>242</sup> If merely improving the sale can extract that value from the property, significant benefits would redound to both mortgagors and junior lienors. Mortgagees who now suffer losses because of uncollected, and perhaps uncollectible, deficiencies would also enjoy an improved position.

### C. Proposing Strict Foreclosure—With Protection for the Mortgagor

If studies show that attempts to significantly improve the foreclosure sale probably will not result in higher prices, a public sale will continue to be a waste of time and money in many foreclosures.<sup>243</sup> A better resolution to the problem might allow the mortgagee to enjoy the efficiency and economy associated with strict foreclosure, but only if the mortgagor is protected.<sup>244</sup> The mortgagee could propose strict foreclosure<sup>245</sup> in any case in which, in his judgment, a sale would not be useful. To protect the interests of mortgagors in these cases, a statute could empower the court to re-

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<sup>240</sup> For some reasons why the retail process may encourage more bidders, see *supra* notes 228-31 and accompanying text.

<sup>241</sup> Other commentators have suggested that a public official should supervise the entire foreclosure process. This "foreclosure commissioner" would conduct the sale in such a way as to generate the highest price and to protect the interests of both mortgagor and mortgagee. Madway & Pearlman, *supra* note 208, at 478-79. See also Lifton, *supra* note 58, at 1942-45 (arguing for rapid appointment of mortgagee or its designee as receiver); Washburn, *supra* note 7, at 935 (noting that proposed Federal Mortgage Foreclosure Act requires mortgagee to designate "foreclosure commissioner" to oversee foreclosure).

<sup>242</sup> *Supra* notes 167-85 and accompanying text.

<sup>243</sup> Fairchild, *supra* note 8, at 5. The wasted money is represented by the additional amount due to the mortgagee above the debt and accrued interest. In the sample, the median such amount was approximately \$1,200, representing a median increment to the debt and accrued interest of 7%, *supra* notes 140-41 and accompanying text. These figures may slightly overstate the actual amounts because in some instances they include unpaid real estate taxes for periods before the foreclosure sale. Nevertheless, in many cases where the foreclosure sale merely transfers the property to the mortgagee in exchange for the debt, a significant portion of the additional amount due represents wasted cash expenditures.

<sup>244</sup> This procedure could build on the existing protections associated with strict foreclosure in jurisdictions permitting its use. See *supra* notes 91-92 and accompanying text.

<sup>245</sup> See UNIFORM LAND TRANSACTIONS ACT § 3-507 (1974) (amended 1978).

quire an independent appraisal of the current retail market value of the property. If the appraisal showed the property to be worth less than the amount of the debt, the mortgagee could foreclose without a sale. In return for avoiding the time and trouble of a pointless public sale, mortgagees would relinquish the right to seek deficiencies.<sup>246</sup> If the appraised value exceeded the debt, the mortgagee could then choose whether to sell the property in a standard retail sale, as described above,<sup>247</sup> or to take title to the property upon paying the mortgagor the difference between the amount of the debt and the appraisal.<sup>248</sup> If the mortgagee chose neither option or did not propose strict foreclosure at all, the mortgagee would retain the traditional right to seek a deficiency, with the protections described above<sup>249</sup> serving to return to mortgagors the profits made on quick resales by mortgagees.

This proposal would benefit mortgagees by avoiding many foreclosure sales that are pointless, wasteful, and inefficient. At the same time, it would fully protect mortgagors from being deprived of their accumulated equity.<sup>250</sup>

#### D. Uncollected Deficiencies—Help for Mortgagees

The study indicates that mortgagees rarely seek deficiencies, even though many foreclosures involve significant uncollected amounts, some of which could have been reduced to deficiency judgments.<sup>251</sup> If the bankruptcy of the mortgagor is the problem, then the mortgagee must bear any losses along with the other creditors. In cases where the mortgagor is not bankrupt, studies should inquire into the reasons mortgagees make no attempt to collect the deficiencies owed them. One possibility is that a mortgagor who loses his real estate in foreclosure is already *in extremis* and will not

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<sup>246</sup> The study indicates that mortgagees rarely seek deficiencies, *see supra* notes 158-62 and accompanying text; therefore, this waiver presumably would not work great hardship on them.

<sup>247</sup> *Supra* notes 237-41 and accompanying text.

<sup>248</sup> Although this suggestion may seem far-fetched to many bankers, its antecedents are found in medieval English mortgages, which "frequently provided that if the mortgagee acquired the land by forfeiture, he would pay an additional sum to the mortgagor, a sum which was apparently intended to reflect the difference between the debt and the value of the land." McGovern, *supra* note 10, at 148.

<sup>249</sup> *See supra* notes 204-22 and accompanying text.

<sup>250</sup> Unlike § 3-507 of the 1974 Official Text of the UNIFORM LAND TRANSACTIONS ACT, which has been criticized because it would severely harm many mortgagors, *see* Madway & Pearlman, *supra* note 208, at 475, this plan to allow the mortgagee to propose strict foreclosure would fully protect the rights of mortgagors. Section 3-507 of the 1974 version has not been carried forward into the 1978 Official Text of the UNIFORM LAND TRANSACTIONS ACT (1978).

<sup>251</sup> *See supra* notes 159-61 and accompanying text.

have any nonexempt assets worth pursuing.<sup>252</sup> Although this explanation may be compelling as to defaulting homeowners, it may not apply to other types of borrowers, such as business borrowers, who may have additional unencumbered assets.

Mortgagees also may not bother seeking deficiencies because the antideficiency legislation passed in the 1930s makes such judgments too difficult to obtain.<sup>253</sup> If further study indicates that the Depression-era antideficiency legislation works too restrictively, the legislation should be modified to allow mortgagees to obtain deficiencies in appropriate cases.

### CONCLUSION

In the study reported in this Article, foreclosure by sale frequently operated as a meaningless charade, producing the functional equivalent of strict foreclosure, a process abandoned long ago. Mortgagees acquired properties at foreclosure sales and resold them at a significant profit in a large number of cases. Many transactions involved single-family homes and resulted in the mortgagor forfeiting his accumulated equity in the property and the mortgagee reaping an unjust windfall. Although mortgagees are legally entitled to collect deficiencies from the mortgagor when they are fairly owed, the mortgagees in the sample rarely attempted to do so. In short, this study indicates that foreclosure by sale is not producing its intended results, and in many cases is yielding unjust and inequitable results.

Because this Article proposes major changes in the law of foreclosure, further empirical study is needed to confirm these findings. Although the sample of foreclosures examined was large enough to yield many statistically significant conclusions, the study was subject to some inherent, unavoidable limitations. Most importantly, the sample was limited to transactions occurring in one county in upstate New York during one year; therefore, drawing conclusions about mortgage foreclosures and resales across the entire United States requires caution.<sup>254</sup> Further sampling in other locations and

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<sup>252</sup> People who default on automobile loans, however, presumably own other valuable, nonexempt assets and often are the subjects of vigorous collection efforts for much smaller amounts. See generally Shuchman, *supra* note 8.

<sup>253</sup> Madway, *supra* note 12, at 150. Another reason why some mortgagees do not pursue deficiencies might be the fear of adverse publicity. *Id.*

<sup>254</sup> A further limitation that must be recognized is that some helpful information was unavailable within the scope of this study. For example, because the mortgagees who were interviewed would not allow access to their records, see *supra* note 113 and accompanying text, it was impossible to determine whether additional expenses were incurred or income was received during the period between the foreclosure sale and later resale. Expenses might include improvements to the property, see *supra* note 194, real estate



of other time periods must determine whether this study's findings and conclusions are representative of the nation as a whole.<sup>255</sup> A reasonable preliminary assumption, however, is that the study represents a valid microcosm of all United States foreclosures and re-sales because no special historical events, economic conditions, or population trends marked Onondaga County from 1979 through 1984.<sup>256</sup>

If a more comprehensive study confirms that foreclosure by sale is working improperly and producing the unjust forfeitures associated with strict foreclosure, our law of mortgage foreclosure requires immediate reform. This Article lays out a plan for reform. The first step would require that mortgagees who purchase a property at their own foreclosure sale and resell it at a profit within a year return that profit to the mortgagor, just as if it were a surplus generated at the foreclosure sale. This change alone would eliminate the major injustice of the present system. At the same time, further study and experimentation should be undertaken to improve the foreclosure sale process, to make it more attractive to third parties, and to generate spirited, competitive bidding. If this effort succeeds, foreclosure by sale would come closer to fulfilling its underlying goals of producing the best possible price, reducing deficiencies, and generating surpluses. Benefits would flow to mortgagors and mortgagees alike. If the public sale cannot be improved, perhaps reformers should eliminate its wasteful aspects and allow limited use of strict foreclosure, with adequate protections for mort-

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brokerage commissions, post-foreclosure real estate taxes, and attorney's fees. Income might be derived by renting out the property during the holding period.

Most of this information is not in the public record. The payment of real estate taxes, however, is in the public record, but the structure of the Onondaga County records made it difficult to distinguish current payments from payments of back taxes, already charged to the mortgagor. Moreover, an informal sampling of real estate taxes paid by mortgagees after foreclosure suggested that this item was generally not of great magnitude. Other unavailable information included the resale price in the tax-exempt transactions, *see supra* note 118, and the possibility that a mortgagor who owned land in Onondaga County might have filed for bankruptcy in a court other than in the Bankruptcy Court in the Northern District of New York, *see supra* note 120 and accompanying text.

Although additional information would be desirable, the lack of such information is probably not of sufficient magnitude to materially alter the conclusions derived from the study.

<sup>255</sup> For example, a study in a jurisdiction that allows statutory redemption or makes extensive use of foreclosure by power of sale might obtain different results. Other differences might appear in major metropolitan or primarily rural areas.

<sup>256</sup> Indeed, as to its populace, the Syracuse area is "demographically representative of the country as a whole," making it an ideal test market for new products. N.Y. Times, Feb. 22, 1984, at B1, col. 3 (quoting Ira Weinblatt, senior vice president and director of media planning for Dancer Fitzgerald, an advertising agency); *see also* SYRACUSE MEDIA INC., THE SYRACUSE GUIDEBOOK '79, at 54 (1978), describing the Syracuse area as "a miniature U.S.A."

gagors. Finally, an effort should be made to determine why mortgagees fail to pursue deficiency judgments; if artificial and unnecessary barriers in the law, such as antideficiency statutes, discourage the pursuit of deficiency judgments, legislatures should remove them. These reforms would restore foreclosure by sale as a fair and equitable procedure, producing a just result for both mortgagors and mortgagees.

APPENDIX

### Selected Data on the 11A Porclosures

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